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(B) DEEMED SALES: There are some transactions which may not be termed as sales because either of the essential elements of the sale is absent. However, by virtue of Article 366(29A) of the Constitution, such transactions have been deemed as sales. These are:-

(i) Compulsory sales: In case of compulsory sales, there is a compulsory transfer of goods under the Government orders, i.e. where goods are a controlled commodity. In such cases, there is no mutual consent between buyer and seller. The seller is under an obligation to sell the goods on the order of the controlling authorities at the controlled prices.

However, as per the conventional definition, there must be a contract between two parties and there should be mutual consent between them for a sale transaction to fructify. Section 2(g)(i) of the Act makes sales tax payable on such a sale even though there is no contract between two parties.

(ii) Sale of goods involved in the execution of works contract: One of the essential elements of sale is that there should be sale of goods. Since works contract involves both sale of goods and provision of services, as per the conventional definition, sales tax could not be levied on it.

Section 2(g)(ii) makes CST payable on the value of goods involved in the inter-State works contract whereas on the value of services, service tax shall be payable.

Guidelines to ascertain whether a transaction is a works contract: To ascertain whether a transaction is a works contract as contemplated in Article 366(29A)(b), the following points should be kept in mind:

1. There must exist an indivisible works contract; divisible contracts are outside the scope.
2. Goods must be involved in the execution of the works contract.
3. Transfer of property must be an integral part of its execution. Property in goods must pass either as goods or in some other form. Form of goods is irrelevant for determination of rate of tax.
4. Property in goods must be transferred during the execution of works not before or after the execution of works.
5. If during the execution of works contract, goods are consumed and their identity is lost, then no transfer of property occurs in those goods.

6. Some work has to be done on the property of the contractee by the contractor.

7. Pure labour contracts or service contracts are outside the purview of the sales tax law.

8. There must be a dominant intention to effect the transfer of property in goods in execution of works contract. However, even if the dominant intention of the contract is rendering of a service and in that process if there is a transfer of property in goods, the contract will amount to a works contract. Building contract is ‘works contract’. Painting or printing is also a ‘works contract’.

9. Job work or processing is ‘works contract’ if property in goods passes to customer during job work.

Note: There can be inter-state sale of goods in works contract and C form can be issued/received. CST is levied on ‘goods involved in the works contract and not on the works contract’.

**Works contract** means a contract for carrying out any work which includes assembling, construction, building, altering, manufacturing, processing, fabricating, erection, installation, fitting out, improvement, repair or commissioning of any movable or immovable property [Section 2(ja)].

(iii) **Hire-purchase or any system of payment by installments**: As per clause (iii) of section 2(g) of CST Act, ‘sale’ includes a delivery of goods on hire-purchase or any system of payment by installments.

Hire purchase is one of the modes of financing an asset. Hire-purchase agreement means an agreement under which owner of the goods let out them on hire to the hirer. Under this transaction, the hirer acquires the possession of goods immediately on signing the hire purchase agreement, but the property in the goods passes to hirer only when the last installment is paid. If the hirer fails to pay any of the installments, the owner takes the asset back without any refund of the earlier installments.

Under installment payment system, the ownership of the goods is passed immediately on payment of the first installment.
(iv) **Lease transactions:** Section 2(g)(iv) covers a sale where property in goods is not transferred; only right to use is transferred. Thus, it makes sales tax payable on the lease transactions.

A lease is a special type of transaction, under which a party owning the asset (called the 'lessor') provides that asset for use over a certain period of time to another party (called the 'lessee') for consideration (called 'rentals'). The **legal ownership of the asset remains with the lessor**, but the lessee retains the possession and uses the asset over the period of the lease. Therefore, the characteristics of a lease can be summarized as under:-

<table>
<thead>
<tr>
<th>There must be a lessor and a lessee, both competent to contract</th>
<th>There must be an asset to be leased</th>
<th>Actual possession and control on the asset must be transferred</th>
<th>There must be an acceptance of the leased property</th>
<th>There must be transfer of right of use by the lessor to the lessee</th>
<th>There must be a consideration</th>
</tr>
</thead>
</table>

Generally, there are two different types of leases:

**Finance lease:** Here the lessor provides finance to the lessee for the purchase of necessary equipments. Machinery and tools, intended to be purchased are purchased in the name of the lessor, but the right to select the assets rests with the lessee. Lessor’s interest in the equipment is that of ownership and the rent received or receivable against such lease. After the end of lease period, the lessee has an option to purchase the leased asset. As per the Accounting Standard (AS 19) on leases issued by the ICAI, a finance lease is a lease that transfers substantially all the risks and rewards incidental to the ownership of an asset.

**Operating lease:** Here the lessor selects the machinery and equipment required to be purchased and then leases out the same to the customer. The ownership is retained by the lessor, but the use of the assets by the lessee is made for a limited period of time. The AS 19 on Leases defines an operating lease as a lease other than a finance lease.

(v) **Sale of goods by any unincorporated association or body of persons to a member:** For sale, there must be distinct buyer and seller. The seller cannot sell the goods to himself. An unincorporated association or body of persons is not a distinct entity from its members. Thus, in case of goods sold by unincorporated association or body of persons to a member, the element of the sale that buyer and seller must be distinct, is absent. Article 366(29A)(e) has empowered the Parliament to tax this transaction and thus this clause has been inserted in the definition of sale.
(vi) **Sale of food articles:** As per section 2(g)(vi), sale includes a supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration.

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**Background for levy of sales tax on deemed sales**

Sales tax laws enacted by various States proceeded on the footing that the expression ‘sale of goods’ would be given a wide expression since it related to entries in the legislative lists.

However, in *Gannon Dunkerley's case* (AIR 1958 SC 560), the Supreme Court held that the expression ‘sale of goods’ would have the same meaning as it had in the Sale of Goods Act, 1930. As a result of this decision, a transaction, in order to be subject to the levy of sales tax under Entry 92A of the Union List or Entry 54 of the State List should have the essential ingredients namely, parties competent to contract, mutual assent and transfer of property in goods from one of the parties to the contract to the other party thereto for a price.

Subsequently, in a number of judgments, Supreme Court held various transactions which in substance, resemble the sale transaction but where one or other element of sale is absent, to be not liable to sales tax (few examples have been discussed below). This position resulted in the scope for avoidance of tax in various ways.

For example, in case of an indivisible works contract, it is not possible to levy sales tax on the transfer of property in the goods involved in the execution of such contract as it has been held that there is no sale of the materials as such and the property in them does not pass as movable.

Though in practice, the purchaser in a hire purchase agreement gets the goods on the date of hire purchase, it has been held that there is sale only when the purchaser exercises the option to purchase at a much later date and therefore, only the depreciated value of the goods involved in such transaction at the time the option to purchase is exercised becomes assessable to sales tax.

Similarly, sales by an unincorporated club or association of persons to its members is not taxable as such club has no separate existence from that of the members.

In another famous judgment, the Supreme Court held that there is no sale involved in the supply of food or drink by a hotelier to a person lodged in the hotel.

The aforementioned problems connected with the power of the States to levy tax on the sale of goods and with the levy of CST, were referred to the Law Commission which recommended that certain amendments should be made in the Constitution to overcome the problems created by the above judicial decisions. Consequently, the Constitution (46th Amendment) Act, 1982 was passed and a new clause (29A) was inserted in Article 366 which empowered both Government of India as well as State Governments to levy tax on such transactions. As per Article 366(29A) of the constitution; “tax on the sale or purchase of goods” includes—

(a) a tax on the transfer, otherwise than in pursuance of a contact, of property in any goods for cash, deferred payment or other valuable consideration;
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(b) a tax on the transfer of property in goods (whether as goods or in some other form) invoked in the execution of a works contract;

(c) a tax on the delivery of goods on hire purchase or any system of payment by installments;

(d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;

(e) a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;

(f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration, and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made.

3. Dealer

Dealer means any person who carries on (whether regularly or otherwise) the business of buying, selling, supplying or distributing goods, directly or indirectly, for cash, or for deferred payment, or for commission, remuneration or other valuable consideration, and includes-

(i) a local authority, a body corporate, a company, any cooperative society or other society, club, firm, Hindu undivided family or other association of persons which carries on such business;

(ii) a factor, broker, commission agent, del credere agent, or any other mercantile agent, by whatever name called, and whether of the same description as hereinbefore mentioned or not, who carries on the business of buying, selling, supplying or distributing, goods belonging to any principal whether disclosed or not; and

(iii) an auctioneer who carries on the business of selling or auctioning goods belonging to any principal, whether disclosed or not and whether the offer of the intending purchaser is accepted by him or by the principal or a nominee of the principal.

Explanation 1 - Every person who acts as an agent, in any State, of a dealer residing outside that State and buys, sells, supplies, or distributes, goods in the State or acts on behalf of such dealer as-

(i) a mercantile agent as defined in the Sale of Goods Act, 1930, or

(ii) an agent for handling of goods or documents of the title relating to goods, or

(iii) an agent for the collection or the payment of the sale price of goods or as a guarantor for such collection or payment, and every local branch or office in a State of a firm registered outside that State or a company or other body corporate, the principal office or headquarters whereof is outside that State, shall be deemed to be a dealer for the purposes of this Act.
Explanation 2 - A Government which, whether or not in the course of business, buys, sells, supplies or distributes, goods, directly or otherwise, for cash or for deferred payment or for commission, remuneration or other valuable consideration, shall except in relation to any sale, supply or distribution of surplus, unserviceable or old stores or materials or waste products or obsolete or discarded machinery or parts or accessories thereof, be deemed to be a dealer for the purposes of this Act [Section 2(b)].

4. **Sales tax law**

_Sales tax law_ means any law for the time being in force in any State or part thereof, which provides for the levy of taxes on the sale or purchase of goods generally or *on any specified goods expressly mentioned in that behalf* and includes Value Added Tax (VAT) law, and _“general sales tax law”_ means the law for the time being in force in any State or part thereof which provides for the levy of tax on the sale or purchase of goods generally and includes VAT law [Section 2(i)].

5. **Business**

_Business_– includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture, whether or not such trade, commerce, manufacture, adventure or concern is carried on with a motive to make profit and whether or not any gain or profit accrues from such trade, commerce, manufacture, adventure, or concern. It also includes any transaction in connection with, or incidental or ancillary to such trade, commerce, manufacture, adventure or concern [Section 2(aa)].

6. **Place of Business**

_Place of business_: includes (i) in any case when a dealer carries on business through an agent (by whatever name called), the place of business of such agent; (ii) a warehouse, godown or other place where a dealer stores his goods; and (iii) a place where a dealer keeps his books of account [Section 2(dd)].

4.8 **Inter-State Sale**

- Inter-State sales under section 3
  - Section 3(a) Direct inter-State Sale
  - Section 3(b) Sale by transfer of documents
A.-Section 3(a)-Where sale occasions movement of goods from one State to another

As per section 3(a), inter-State sale takes place if sale occasions the movement of goods from one State to another. In this regard, following points merit consideration:

- The stipulation for movement of goods outside the State may be either expressed or implied.
- It is immaterial in which State the ownership of the goods is passed on to the buyers.
- Movement of goods should be incident of sale and should be necessitated by the contract of sale. Thus, it must be inter-linked with the sale of goods.
- Mode of transport of goods is immaterial. It may be aircraft, rail, motor transport, angadia, ship or handicraft.
- For the purpose of section 3(a), there is no distinction between unascertained/future goods and the goods which are already in existence.

**Note:** Where the movement of goods commences and terminates in the same State it shall not be deemed to be a movement of goods from one State to another by reason merely of the fact that in the course of such movement, the goods pass through the territory of any other State [Explanation 2 to section 3].

**Examples to illustrate the concept of inter-State sale under section 3(a)**

**Example 1:** Even if the buyer and seller are in the same State, it is an inter-State sale if the sale occasions the movement of goods from one State to another.

1. B directs A to despatch some goods directly to his factory in Mumbai.
2. A despatches the goods from Vapi to Mumbai.

**Sale of goods from A to B is an inter-State sale**
Example 2: Movement of goods on the basis of telephonic conversation is sufficient to be held as inter-State sale

Example 3: Even if the buyer is located outside the State, sale is not an inter-State sale if the goods do not move outside the State

B.-Section 3(b)-Where sale or purchase is effected by a transfer of documents of title to the goods during their movement from one State to another

As per section 3(b), a sale or purchase shall be deemed to take place in the course of inter-State trade or commerce if the sale or purchase is effected by a transfer of documents of title to the goods during their movement from one State to another*.
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*It is important to note here that unlike section 3(a), the movement of goods from one State to another need not necessarily be occasioned by sale under this clause.

**ANALYSIS**

(a) **Meaning of ‘Documents of title to the goods’**: Documents of title to the goods is generally a lorry receipt in case of transport by road, railway receipt in case of transport by rail, bill of lading in case of transport by sea and airway bill in case of transport by air.

Document of title to the goods substantiates that the person holding the document has the title to the goods mentioned in the document. Transfer of title to the goods means transfer of right of possession of such goods or control over such goods. Thus, a person in whose name the document of title to the goods is endorsed would be entitled to the delivery of the goods.

**Document of title to the goods as per the Sales of Goods Act, 1930:**

As per section 2(4), document of title to the goods includes a bill of lading, dock warrant, warehouse keeper’s certificate, wharfingers’ certificate, railway receipt, multimodal transport document, warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented.

(b) **Transfer must be during the movement of goods**: A sale would be covered under clause (b) of section 3 [and termed as inter-State sale] if sale/purchase is effected by transfer of documents of title to the goods **during the movement of such goods** from one place to another.

**Commencement and termination of movement of goods**: Where goods are delivered to a carrier or other bailee for transmission, the movement of the goods shall be deemed
to commence at the time of such delivery and terminate at the time when delivery is taken from such carrier or bailee [Explanation 1 to section 3].

Thus, any sale by transfer of documents of title to the goods after the goods are delivered to a carrier, but before physical delivery of such goods is taken at the final destination would be termed as inter-State sale.

Example 1: Ram, a dealer in Haryana, got an order for delivery of goods in U.P. He sent the goods from Haryana to U.P. by rail. In this case, movement of goods commenced at the time when the goods were handed over to the railway booking office at Haryana for transportation to U.P.

The movement of goods would be deemed to continue even if the goods reach U.P. and were lying in the possession of railways. Movement would be deemed to be terminated only at the time when delivery was actually taken at U.P. on submission of railway receipt.

Example 2:

Example 2:

4.9 Inter-State stock transfer/inter-State consignment transfer [Section 6A]

Sometimes, a dealer (principal) sends the goods to his consignment agent in another State so that the goods are sold by the agent in that State on his behalf. Similarly, a dealer may send the goods to his own branch/depot in another State from where such goods can be sold. Section 6A applies to a situation where the goods are sent by a dealer, outside the State to his other place of business or his agent/principal in other State. In other words, this section covers the inter-State consignment transfer/ inter-State branch transfer.

In the aforesaid cases, although goods have been transferred from one State to another, generally, the property in goods does not pass from principal to the agent. Thus, there is no
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sale and consequently, no CST is payable provided there was no pre-existing agreement for the sale of the goods so transferred.

The burden of proving that the movement of those goods was occasioned NOT by reason of sale shall be on the dealer transferring the goods to his branch/agent/principal. For this purpose, he may furnish Form F to the assessing authority, within 3 months from the end of the period to which such form relates, obtained from the principal officer of the other place of business, or his agent or principal.

**Examples illustrating the concept of inter-State stock transfer/branch transfer:**

**Example 1**

Mr. A, a registered dealer, transferred goods from his factory in Gujarat to Mumbai branch so that the goods can be sold from there.

<table>
<thead>
<tr>
<th>Factory</th>
<th>Branch</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gujarat</td>
<td>Mumbai</td>
</tr>
</tbody>
</table>

Buyer was not known and identified before the despatch of the goods.

It is an inter – State stock transfer and hence NOT an inter-State sale.

**Example 2**

Maharashtra Government formulated a policy under which it issued ‘allotment cards’ to the weavers. The weavers, on production of such allotment cards, could get the ‘viscose yearn’ at concessional rates. In the below mentioned example, weavers submitted the allotment cards to
Mr. X, a dealer of viscose yarn in Maharashtra. On receiving these cards in branch from the weavers, Mr. X got the goods despatched from his factory in Tamilnadu to his branch in Maharashtra.

4.10 Sale outside the State [Section 4]

States are empowered to impose tax only on intra-State sales and not on inter-State sales of goods by virtue of Entry 54 of the State List.

Further, Article 286(1)(a) of the Constitution of India stipulates that State cannot impose a tax on the sale or purchase of goods where such sale or purchase takes place outside the State and the power to formulate principles for determining as to when a sale or purchase of goods shall be deemed to have taken place outside the State has been conferred on the Parliament by clause (2) of Article 286.

Combined reading of article 286 and Entry 54 makes it apparent that a State can levy sales tax only on intra-State sales of goods provided such sales takes place inside such State and outside all other States.

The principles as to when a sale is deemed to take place inside a State and when it is deemed to take place outside a State have been formulated under section 4 of the Central Sales Tax Act. It reads as follows:-

(1) Subject to the provisions contained in section 3, when a sale or purchase of goods is determined in accordance with sub-section (2) to take place inside a State, such sale or purchase shall be deemed to have taken place outside all other States.

(2) A sale or purchase of goods shall be deemed to take place inside a State if the goods are within the State-

(a) in the case of specific or ascertained goods, at the time the contract of sale is made; and
(b) in the case of unascertained or future goods, at the time of their appropriation to the contract of sale by the seller or by the buyer, whether assent of the other party is prior or subsequent to such appropriation.

Explanation- Where there is a single contract of sale or purchase of goods situated at more places than one, the provisions of this sub-section shall apply as if there were separate contracts in respect of the goods at each of such places.

ANALYSIS: Before going through the provisions of section 4, one must be conversant with the concept of specific goods, ascertained goods and unascertained goods as explained hereunder:-

- **Specific goods**: means goods identified and agreed upon at the time a contract of sale is made [Section 2(14) of the Sales of Goods Act, 1930]. Thus, these are the goods which are in existence and which are identified by the parties at the time of contract of sale.

- **Unascertained goods**: means the goods defined only by description and not identified and agreed upon at the time of contract. Unascertained goods may be existing goods or future goods.

- **Ascertained goods**: Unascertained goods become “ascertained” when after the contract of sale has been made, the goods are identified in accordance with the agreement.

Section 4(1) does not actually define what is a ‘Sale outside a State’, but instead it describes what is a ‘Sale inside a State’ and that such a sale shall be outside all the other States.

(a) **When is a sale/purchase deemed to take place inside a State?:** A sale or purchase of goods shall be deemed to take place inside a State:

- if the goods are within the State at the time the contract of sale is made
- if the goods are within the State at the time of their appropriation to the contract of sale by the seller or by the buyer*

*Note: It is immaterial whether the other party to the contract gives his assent to the appropriation prior or subsequent to such appropriation.
(b) When is a sale/purchase deemed to take place outside a State?: When a sale or purchase of goods has taken place inside a State in accordance with aforesaid provisions, such sale or purchase shall be deemed to have taken place outside all other States.

Illustrations explaining the concept of sale inside a State and sale outside a State

Example 1: Sale of specific goods

Example 2: Sale of unascertained goods

(c) Single contract of sale of goods situated at more than one places

In the case of both the above groups of goods (specific and unascertained), it may so happen that there is a single contract of sale or purchase of goods situated at more than one places. In such a case it shall be deemed that there are separate contracts in respect of the goods at each of such place.

(d) Section 4 is subject to the provisions of section 3

Section 4 is subject to the provisions of section 3. It implies that the provisions of section 4 would apply only when sales of goods is not an ‘inter-State sale’ under section 3. In case of
intra-State sales, sales tax shall be levied by the State inside which such sales is deemed to have taken place.

4.11 Sale in course of import/export [Section 5]

Article 286(1)(b) of the Constitution of India stipulates that State cannot impose a tax on the sale or purchase of goods where such sale or purchase takes in the course of import/export. Further, clause (2) of Article 286 confers the power on the Parliament to formulate principles for determining when a sale or purchase of goods shall be deemed to have taken place in the course of import/export.

In exercise of the powers conferred by the Constitution, section 5 was introduced. Section 5 stipulates as to when a sale or purchase is deemed to take place in the course of import/export. Central sales tax is not leviable on sale in course of export/import. The provisions of section 5 have been discussed hereunder:

<table>
<thead>
<tr>
<th>Sale in the course of export</th>
</tr>
</thead>
<tbody>
<tr>
<td>A sale or purchase of goods shall be deemed to take place in course of export of goods out of the territory of India only if:</td>
</tr>
<tr>
<td>(i) sale or purchase occasions such export, or</td>
</tr>
<tr>
<td>(ii) sale or purchase is effected by a transfer of documents of title to the goods after the goods have crossed the customs frontiers of India, or</td>
</tr>
<tr>
<td>(iii) it is penultimate sales.</td>
</tr>
<tr>
<td><strong>(a) Sale/purchase occasioning the export:</strong> In such a case:</td>
</tr>
<tr>
<td>(i) there shall be a sale of goods;</td>
</tr>
<tr>
<td>(ii) such sale shall occasion export, involving transhipment of goods from one country to the other and shall be between two parties of two countries and</td>
</tr>
<tr>
<td>(iii) the final result of transhipment shall be that the goods have come to rest in the other country.</td>
</tr>
</tbody>
</table>

**Example:**

A enters into a contract of sale with B and moves the goods out of the territory of India

In this case, the sale would be deemed to have occasioned the export of the goods out of the territory of India and would not be liable to CST.
(b) Sale or purchase effected by a transfer of documents of title to the goods: In such a case, sale is effected by a transfer of documents of title to the goods **AFTER** the goods have crossed the customs-frontiers of India. Such transfer of documents of title to the goods can take place immediately on loading of goods in a conveyance after obtaining clearance from the customs authorities for export.

**Example:**

'\(A\)' shipped the goods for transfer to his branch in London. After the goods are loaded on ship, 'A' got an order from a customer in London for the said goods. So, the document of title to such goods was endorsed in favour of the said customer.

In this case, the sale would be deemed to be sale in course of export effected by transfer of documents and as such would NOT be liable to CST.

**Points which merit consideration regarding sale occasioning export of goods or sale effected by transfer of documents of title to the goods after goods cross the customs frontier**

- Sale to a foreign tourist in India is not 'sale in course of export'.
- Sale in course of export is not liable to CST even if made by an unregistered dealer.
- The goods should be destined to foreign country even though actual reaching of destination is not necessary.
(c) **Penultimate sales for export**: Penultimate sale is the sale preceding the sale occasioning the export. Such sale would also be deemed to be the sale in course of exports and would not be liable to central sales tax.

However, the penultimate sale or purchase is considered to be a sale or purchase in the course of export only if the dealer selling the goods furnishes a declaration in Form H, duly filled in and signed by the exporter to whom the goods are sold, to the prescribed authority in the prescribed form and manner.

**Conditions to be fulfilled for a sale to be considered as penultimate sale**:

A sale is considered as penultimate sale if all the following conditions are fulfilled:

(i) There is a pre-existing **agreement or order in relation to export** [agreement with a foreign buyer and not an agreement or order with a local party containing the covenant to export].

(ii) Penultimate sale must be, **after the agreement** with the foreign buyer, for the purpose of complying with such agreement or order in relation to export.

(iii) Same goods which are sold in penultimate sale must be exported, though may not be in the same form.

**Example**: ABC Ltd. received export order for edible prawns. It purchased prawns from a local dealer and cleaned them. A small inedible portion was removed and the edible portion was exported. In the given case, purchase of prawns is a penultimate sale for exports.

(d) **Purchase of ATF by any designated Indian carrier for the purposes of its international flight deemed to take place in course of export**

If any designated Indian carrier purchases Aviation Turbine Fuel for the purposes of its international flight, such purchase shall be deemed to take place in the course of the
Basic Concepts of Indirect Taxes – Central Sales Tax

export of goods out of the territory of India.
In this regard, following points merit consideration:-

- CST and sales tax within the State will not be applicable on such purchase as it is not an inter-State sales, but a purchase in the course of the export.
- Exemption is only available to Indian carriers notified by the Central Government in this behalf. Some of the designated Indian carriers so specified are Air India, Indian Airlines, Jet Airways and Spicejet.
- Exemption is available only in case of international flights and not the domestic flights.

### Sale in the course of import

A sale or purchase of goods shall be deemed to take place in course of import of goods into the territory of India only if:-

(i) sale or purchase occasions such import, or
(ii) sale or purchase is effected by a transfer of documents of title to the goods before the goods have crossed the customs frontiers of India,

(a) **Sale occasioning the import:** Below mentioned example elucidates the concept of sales occasioning the import:

(b) **Sale or purchase effected by a transfer of documents of title to the goods:** In such a case, sale is effected by a transfer of documents of title to the goods **BEFORE** the goods have crossed the customs-frontiers of India. Such transfer of documents of title to the goods can take place at any time before clearance of goods from customs. Import starts when the goods cross the customs barrier in a foreign country and ends when they cross customs barrier in the importing country.

Further, if the documents are transferred when goods are in customs bonded warehouse, it will be treated as transfer of documents before the goods cross the customs barrier. However, on the other hand, if the imported goods are cleared from customs and then sold to a buyer in
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India, such sale would not be termed as sale in course of import. Such sale shall be inter-
State sale or intra-State sale, as the case may be.

For instance, if Bill of Lading is endorsed in favour of buyer before the goods have crossed
the limit of customs port or if the letter of delivery issued by bank is endorsed in favour of
buyer before taking the delivery from customs, it is sale in course of imports.

Example:

Meaning of crossing the customs frontiers of India: Crossing the customs frontiers of India
means crossing the limits of the area of a customs station* in which imported goods/export
goods are ordinarily kept before clearance by customs authorities.

*Customs station means any customs port [in case of a vessel], customs airport [in case of an aircraft]
or land customs station [in case of a vehicle].

4.12 Rates of tax on sales in the course of inter-State trade or
commerce

As per section 8(1), the liability to pay CST is on the dealer who sells the goods in the course
of inter-State trade or commerce. For computing CST payable, the applicable rates would be
determined as per the provisions of sub-sections (1) to (4) of section 8, in the following
manner:

CASE – I : CONCESSIONAL RATE OF CST IS APPLICABLE:

The concessional rate of CST is:-

(i) 2% of the turnover of the dealer

or

(ii) Rate applicable to the sale or purchase of such goods inside the appropriate state* under
the sales tax law of that State

whichever is lower.
Basic Concepts of Indirect Taxes – Central Sales Tax

Appropriate State means-
(i) in relation to a dealer who has one or more places of business situated in the same State: that State;
(ii) in relation to a dealer who has places of business situated in different States: every such State with respect to the place or places of business situated within its territory [Section 2(a)].

Conditions to be fulfilled for concessional rate of CST: A dealer is liable to pay CST at the concessional rate provided the following conditions are satisfied:
(I) Sale is of eligible goods: Goods described in sub-section (3)* are the goods eligible for concessional rate of CST (refer Note below).
(II) Sale is made to a registered dealer: The dealer can pay CST on inter-State sale of such eligible goods at the concessional rate provided the sale has been made to a registered dealer.
(III) Form C to be furnished by the purchasing dealer: The selling dealer is required to obtain a declaration in Form C from the purchasing dealer and furnish it to the prescribed authority, in order to secure the concession in rate of tax.

*Note: Following goods as specified in the certificate of registration of the registered purchasing dealer, are eligible for concessional rate of CST:-
(a) goods of the class/classes intended:-
   (i) for resale by him, or
   (ii) for use by him in manufacture or processing of goods for sale, or
   (iii) for use in the telecommunications network, or
   (iv) for use in mining, or
   (v) for use in the generation or distribution of electricity or any other form of power.
(b) containers or other materials intended for being used for the packing of goods for sale.

Further, containers or other materials used for the packing of any goods referred to in clause (a) or (b) above are also so eligible [Section 8(3)].

CASE – II: CONCESSIONAL RATE OF CST IS NOT APPLICABLE:

In case any of the aforesaid three conditions are not fulfilled, the rate of CST would be the rate applicable to the sale or purchase of such goods inside the appropriate State under the sales tax law of that State.
1.106 Indirect Taxes

Rates of CST at a glance:-

<table>
<thead>
<tr>
<th>In case rate of sales tax within the State is</th>
<th>CST rate in case of sale to registered dealers is</th>
<th>CST rate in case of sale to unregistered dealers is</th>
</tr>
</thead>
<tbody>
<tr>
<td>less than 3%</td>
<td>applicable rate of sales tax within the State</td>
<td>applicable rate of sales tax within the State</td>
</tr>
<tr>
<td>3% or more</td>
<td>2%</td>
<td></td>
</tr>
</tbody>
</table>

Illustration: Ram of Gujarat, a registered dealer, purchases goods specified in section 8(3) from Shyam of Maharashtra and furnishes Form C to Shyam with regard to such purchase of goods. Calculate the CST rate applicable assuming that the rate of sales tax within Maharashtra is:-

(i) Nil
(ii) 1%
(iii) 2%
(iv) 3%
(v) 4%
(vi) 5%
(vii) 8%
(viii) 10%
(ix) 13.5%
(x) 20%

Will your answer be different in case Ram is not a registered dealer?

Solution:

<table>
<thead>
<tr>
<th>Sales tax rate for sale within the State</th>
<th>CST rate in case Ram is a registered dealer and furnishes Form C</th>
<th>CST rate in case Ram is an unregistered dealer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>1%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>2%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>3%</td>
<td>2%</td>
<td>3%</td>
</tr>
<tr>
<td>4%</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>5%</td>
<td>2%</td>
<td>5%</td>
</tr>
<tr>
<td>8%</td>
<td>2%</td>
<td>8%</td>
</tr>
<tr>
<td>10%</td>
<td>2%</td>
<td>10%</td>
</tr>
<tr>
<td>12.5%</td>
<td>2%</td>
<td>12.5%</td>
</tr>
<tr>
<td>20%</td>
<td>2%</td>
<td>20%</td>
</tr>
</tbody>
</table>
4.13 Determination of turnover for central sales tax [Section 8A]

Turnover means the aggregate of the sale prices received and receivable by any dealer liable to CST under this Act in respect of sales of any goods in the course of inter-State trade or commerce made during any prescribed period* and determined in accordance with the provisions of this Act and the rules made thereunder [Section 2(j)].

*Prescribed period is the period in respect of which a dealer is liable to submit returns under the general sales tax law of the appropriate State. However, if a dealer is not liable to submit returns under the general sales tax law of the appropriate State, such period shall be a quarter ending on 30th June, 30th September, 31st December and 31st March, as the case may be, in a financial year.

Example: Mr. A is a dealer registered in Delhi. He is required to file the return quarterly under the Delhi VAT Act, 2004. Thus, for the purposes of the Central Sales Tax Act, the turnover would be the aggregate of the sale prices received and receivable by him in respect of sales of any goods in the course of inter-State trade or commerce made during three months.

DEDUCTIONS TO BE MADE WHILE COMPUTING THE TURNOVER

While determining the turnover of a dealer for the purposes of computing CST payable, following deductions shall be made from the aggregate of the sale prices:-

(i) Central sales tax payable

(ii) Sale price of all goods returned to the dealer by the purchasers of such goods within a period of six months from the date of delivery of the goods.

(iii) Such other deductions as the Central Government may, having regard to the prevalent market conditions, facility of trade and interests of consumers, prescribe [Section 8A].

ANALYSIS: Following deductions are allowed to be made from the aggregate of the sale prices while computing the turnover:-

(i) Central sales tax payable: The aggregate of sales price is taken inclusive of central sales tax, whether it is shown separately in the invoice or not.

Consequently, the turnover is arrived at by deducting the CST from the aggregate of sales price. CST is calculated as follows:-

\[
\text{CST} = \left( \frac{\text{Aggregate of sales price}}{1 + \text{Rate of tax}} \right)
\]

Alternatively, turnover may be calculated by making back calculation in the following manner:-

\[
\text{Turnover} = \left( \frac{\text{Aggregate of sales price}}{1 + \text{Rate of tax}} \right)
\]
Explanation - Where the turnover of a dealer is taxable at different rates, the aforesaid formulas shall be applied separately in respect of each part of the turnover liable to a different rate of tax.

(ii) Sale price of all goods returned by the purchasers: Deduction of sale price of all goods returned is available from the aggregate of the sales prices provided:

(a) the goods are returned by the purchaser within a period of 6 months from the date of delivery of the goods, and

(b) satisfactory evidence of such return of goods and of refund or adjustment in accounts of the sale price thereof is produced before the competent authority.

(iii) Such other deductions as the Central Government may, having regard to the prevalent market conditions, facility of trade and interests of consumers, prescribe.

Note: The period of six months for return of goods is not applicable in respect of rejected goods as it is a case of un-fructified sale.

MEANING OF SALE PRICE

**Sale price** means the amount payable to a dealer as consideration for the sale of any goods, less any sum allowed as cash discount according to the practice normally prevailing in the trade, but inclusive of any sum charged for anything done by the dealer in respect of the goods at the time of or before the delivery thereof other than the cost of freight or delivery or the cost of installation in cases where such cost is separately charged [Section 2(h)].

**ANALYSIS:**

(A) **Definition of sale price:** As per section 2(h), sale price means the amount payable to a dealer as consideration for the sale of any goods subject to following inclusions and exclusions:

Inclusions in the sale price:- Any sum charged for anything done by the dealer in respect of the goods at the time of or before the delivery thereof.

Exclusions from the sale price:- Following are to be excluded from the sale price:

(a) Any sum allowed as cash discount according to the practice normally prevailing in the trade.

(b) **Cost of freight/delivery:** The cost of freight/delivery or cost of installation is excluded where such cost is separately charged by the dealer.

Cost of freight or delivery is includible only if:

(a) it is NOT shown separately in an invoice or

(b) Contract is for sale FOR destination and property in goods is transferred only at destination.

In case of sale of goods from depot, freight from factory to depot is includible in sale price even if shown separately in invoice.
(B) **Other Inclusions and Deductions from sale price:** In addition to the inclusions and exclusions (as discussed above) from the sale price specifically mentioned in the definition of sale price, few other inclusions and exclusions have been discussed below. The same have been arrived at on the basis of the legal decisions rendered in this regard.

1. **Dharmada** - Charity or dharmada collected by the dealer will form part of the sale price because so far as the purchaser is concerned, he has to pay the whole amount for purchasing the goods.

2. **Weighment dues** - If the services of weighing are in respect of the goods and incidental to their being sold, the dues charged are to be included in the sale proceeds.

3. **Insurance charges** - Insurance charges incurred by the assessee prior to the delivery of the goods form part of sale price. However, transit insurance charges incurred at request by buyer are not chargeable to CST.

4. **Packing charges** - The packing charges realised by the dealer is an integral part of the sale price and hence includible. Further, cost of packing material is also includible in sale price.

5. **Indemnity/Guarantee charges** - Indemnity / guarantee charges recovered from the same buyers to incur loss during transit at buyers' request are allowed as deduction from the sale price.

6. **Discount according to trade practice** - Any sum allowed as discount according to the practice normally prevailing in the trade will not form part of the “sale price”.

7. **Excise duty** - Excise duty paid by a dealer in respect of the goods which he sells will not be liable to be deducted from his turnover.

8. **Government subsidies** - Where a product is ‘controlled’ and has to be sold at ‘controlled price’ subsidies are granted by the Government to manufacturers to compensate the cost of production which is usually higher than the controlled price. Such subsidy will not form part of sale price or turnover.

9. **Design Charges** – Design charges charged separately in respect of goods manufactured as per design and sold to buyer are includible.

10. **Deposits for returnable containers/bottles:** are not includible in the sale price.

11. **Free of cost material supplied by customer** – is not includible in sale price.

(C) **Sale price in case of works contract:** In the case of a transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract, the sale price of such goods shall be determined in the prescribed manner* by making such deduction from the total consideration for the works contract as may be prescribed and such price shall be deemed to be the sale price for the purposes of this clause.
*Note: So far no rules have been framed by the Central Government.

**Collection of tax to be only by registered dealers [Section 9A]**

No person who is not a registered dealer shall collect in respect of any sale made by him of goods in the course of inter-State trade or commerce any amount by way of tax under this Act, and no registered dealer shall make any such collection except in accordance with this Act and the rules made thereunder.

**CST payable to be rounded off [Section 9B]**

The amount of central sales tax, interest, penalty, fine or any other sum payable, and the amount of refund due, under the provisions of this Act shall be rounded off to the nearest rupee*.

However, this provision does not apply to CST collected by a dealer. It implies that when a dealer collects CST from the buyer, he may charge it in the invoice without rounding off, but when the same is credited to the Government, amount needs to be rounded off to the nearest rupee.

*Note: For this purpose, where such amount contains a part of a rupee consisting of paisa, then, if such part is fifty paisa or more, it shall be increased to one rupee and if such part is less than fifty paisa, it shall be ignored.

**SOME ILLUSTRATIONS EXPLAINING THE COMPUTATION OF CST LIABILITY:**

**Illustration 1:** Mr. D, a first stage dealer in packing machinery in the State of Gujarat furnishes the following data:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale proceeds of inter-State sales during F.Y. 2014-15 (CST not shown separately)</td>
<td>₹92,50,000</td>
</tr>
<tr>
<td><strong>Above sales include:</strong></td>
<td></td>
</tr>
<tr>
<td>Excise duty</td>
<td>₹9,00,000</td>
</tr>
<tr>
<td>Freight</td>
<td>₹1,50,000</td>
</tr>
<tr>
<td>(of this ₹50,000 is not shown separately in invoices)</td>
<td></td>
</tr>
<tr>
<td>Insurance charges incurred prior to delivery of goods</td>
<td>₹32,000</td>
</tr>
<tr>
<td>Installation and commissioning charges shown separately</td>
<td>₹15,000</td>
</tr>
<tr>
<td>Design charges charged separately</td>
<td>₹30,000</td>
</tr>
</tbody>
</table>

Determine the turnover and CST payable, assuming that all transactions were covered by valid ‘C’ Forms and sales tax rate within the State is 5%.
Solution:

**Computation of Mr. D’s turnover and central sales tax payable**

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale proceeds of inter-state sales</td>
<td>₹92,50,000.00</td>
</tr>
<tr>
<td>Less: Freight shown separately in the invoices</td>
<td>₹1,00,000</td>
</tr>
<tr>
<td>Less: Installation and commissioning charges shown separately</td>
<td>₹15,000</td>
</tr>
<tr>
<td>Turnover including CST (A)</td>
<td>₹91,35,000.00</td>
</tr>
<tr>
<td>Less: CST payable (91,35,000 × 2/102) (B)</td>
<td>₹1,79,117.65</td>
</tr>
<tr>
<td>Turnover excluding CST (A - B)</td>
<td>₹89,55,882.35</td>
</tr>
<tr>
<td>Central sales tax payable (rounded off)</td>
<td>₹1,79,118</td>
</tr>
</tbody>
</table>

**Notes**
1. Excise duty forms part of the sale price and is not deductible.
2. Freight not shown separately in the invoices and insurance charges incurred prior to delivery of goods are not deductible in calculating the turnover.
3. Sale price includes design charges charged separately.
4. The CST on transactions covered by valid ‘C’ forms is 2% or the sales-tax rate within the State, whichever is lower. Since, in this case, the State sales-tax rate is higher than 2%, the rate of CST is taken as 2%.

**Illustration 2:** Mr. X reported inter-State sales of ₹36,20,000. This includes the following:
(i) Excise duty ₹3,00,000; and
(ii) Deposit for returnable containers and packages ₹5,00,000.

Central sales tax was not included separately in the sales invoice.

Compute tax liability under the CST Act, assuming the rate of CST at 2%.

**Solution:**

**Computation of central sales tax liability of Mr. X**

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total sales of Mr. X</td>
<td>₹36,20,000.00</td>
</tr>
<tr>
<td>Less: Deposit received towards returnable containers and packages</td>
<td>₹5,00,000.00</td>
</tr>
<tr>
<td>Turnover (including central sales tax)</td>
<td>₹31,20,000.00</td>
</tr>
<tr>
<td>Less : Central sales tax thereon = 31,20,000 x 2/102</td>
<td>₹61,176.47</td>
</tr>
<tr>
<td>Turnover (excluding central sales tax)</td>
<td>₹30,58,823.53</td>
</tr>
</tbody>
</table>
The central sales tax liability is ₹ 61,176 [rounded off] (being 2% of ₹ 30,58,823.53)

Note – Excise duty is part of turnover and hence should not be excluded from turnover.

Illustration 3: Mr. A’s total inter-State sales are ₹ 52,00,000 for the year ended 31.03.2015. Further, goods sold in March, 2015 have been returned by the customers to the value of ₹ 5,20,000 in May, 2015. He had not charged tax separately in the sale invoices. Assuming that the applicable rate of CST is 2%, compute his CST liability.

Solution:

<table>
<thead>
<tr>
<th>Description</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total sales</td>
<td>52,00,000</td>
</tr>
<tr>
<td>Less : Sale price of goods returned to the dealer by the purchaser of such</td>
<td>5,20,000</td>
</tr>
<tr>
<td>goods (within 6 months from the date of delivery of the goods)</td>
<td></td>
</tr>
<tr>
<td>Turnover in terms of the Central Sales Tax Act</td>
<td>46,80,000</td>
</tr>
</tbody>
</table>

Mr. A has not charged the amount of sales tax separately in the sales invoices. Therefore, according to section 8A, the sales tax has to be worked out applying the following formula

\[
\text{Central sales tax liability} = \frac{2 \times \text{Aggregate of sale price}}{100 + \text{Rate of tax}}
\]

\[
= \frac{2 \times 46,80,000}{102}
\]

\[
= 93,60,000
\]

\[
= 91,765 \text{ (rounded off)}
\]

Illustration 4: From the following details, compute the central sales-tax payable by a dealer carrying on business in New Delhi:

<table>
<thead>
<tr>
<th>Description</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total inter-State sales (including CST)</td>
<td>16,00,000</td>
</tr>
<tr>
<td>(i) Trade commission for which credit notes have to be issued separately</td>
<td>48,000</td>
</tr>
<tr>
<td>(ii) Installation charges charged separately</td>
<td>25,000</td>
</tr>
<tr>
<td>(iii) Excise duty</td>
<td>80,000</td>
</tr>
<tr>
<td>(iv) Freight, insurance and transport charges recovered separately in the</td>
<td>60,000</td>
</tr>
<tr>
<td>invoice</td>
<td></td>
</tr>
<tr>
<td>(v) Goods returned by dealers within six months of sale, but after the end</td>
<td>40,000</td>
</tr>
<tr>
<td>of the financial year</td>
<td></td>
</tr>
</tbody>
</table>

Buyers have issued ‘C’ forms for all purchases.

Sales tax rate within the State is 4%.
**Basic Concepts of Indirect Taxes – Central Sales Tax**

**Solution:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales as per bill (including CST)</td>
<td>16,00,000</td>
</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Trade commission</td>
<td>48,000</td>
</tr>
<tr>
<td>Installation charges charged separately</td>
<td>25,000</td>
</tr>
<tr>
<td>Freight, transport charges</td>
<td>60,000</td>
</tr>
<tr>
<td>Goods returned within 6 months</td>
<td>40,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,73,000</strong></td>
</tr>
<tr>
<td><strong>Turnover including CST</strong></td>
<td><strong>14,27,000</strong></td>
</tr>
<tr>
<td>Central sales tax @ 2% (₹14,27,000 x 2 / 102)</td>
<td>27,980.39</td>
</tr>
<tr>
<td><strong>Turnover</strong></td>
<td><strong>13,99,019.61</strong></td>
</tr>
<tr>
<td><strong>CST at 2% thereof (rounded off)</strong></td>
<td><strong>27,980</strong></td>
</tr>
</tbody>
</table>

**Note:** The CST on transactions covered by valid ‘C’ forms is 2% or the sales-tax rate within the State, whichever is lower. Since, in this case, the State sales-tax rate is higher than 2%, the rate of CST is taken as 2%.

### 4.14 Exceptions to levy of central sales tax (CST)

1. **No CST on penultimate sales for export** [Proviso to section 6(1)]

   A dealer shall not be liable to pay CST on the penultimate sales for export under section 5(3).

2. **No CST on subsequent sales** [Section 6(2)]

   Where a sale of any goods in the course of inter-State trade or commerce has either occasioned the movement of such goods from one State to another or has been effected by a transfer of documents of title to such goods during their movement from one State to another, any subsequent sale during such movement effected by a transfer of documents of title to such goods to a registered dealer, if the goods are of description referred to in section 8(3), shall be exempt from tax under this Act.
1.114  Indirect Taxes

However, no such subsequent sales shall be exempt from tax under this sub-section unless the dealer effecting the sale furnishes to the prescribed authority within three months after the end of the period to which the declaration/certificate relates or within such further time as that authority may, for sufficient cause, permit.--

(a) a certificate duly filled and signed by the registered dealer from whom the goods were purchased containing the prescribed particulars in a prescribed form obtained from the prescribed authority (Form E-I/ Form E-II); and

(b) if the subsequent sale is made to a registered dealer, a declaration referred to in sub-section (4) of section 8 (Form C).

Further, it shall not be necessary to furnish Form C as referred to in clause (b) above in respect of a subsequent sale of goods if,-

(a) the sale or purchase of such goods is, under the sales tax law of the appropriate State, exempt from tax generally or is subject to tax generally at a rate which is lower than 3% (whether called a tax or fee or by any other name); and

(b) the dealer effecting such subsequent sale proves to the satisfaction of the prescribed authority that such sale is of the nature referred to in this sub-section.

ANALYSIS: Since every sale, in the course of inter-State trade, is liable to tax, the levy can become a multiple levy if the goods change hands several times during their movement from one State to another. Thus, section 6(2) provides that subsequent inter-State sale of the goods shall not be liable to CST if the following conditions are satisfied:-

(i) First sale to be an inter-State sale: First sale should be an inter-State sale i.e. either (a) sale of goods occasioning the movement of goods from one State to another or (b) sale effected by the transfer of documents of title to the goods. Moreover, the subsequent sale should be effected by the transfer of documents of title to the goods during the movement of such goods in course of inter-State sales.  

Note: Subsequent sales is not liable to CST even if the first inter-State sale is exempt from CST.

(ii) Subsequent sales to a registered dealer: Sale subsequent to an inter-State sale is exempt only if:-

(a) purchaser is a registered dealer.

(b) the goods are of description referred to in section 8(3).

(iii) Prescribed certificates to be furnished: The dealer effecting the subsequent sale needs to furnish following certificates/declaration:-

(a) Form E-I/ Form E-II*: obtained from the registered dealer from whom he has purchased the goods, and

(b) Form C: Form C obtained from such dealer if subsequent sale is made to a registered dealer.
Basic Concepts of Indirect Taxes – Central Sales Tax  1.115

*Note: Form E-I is issued by the selling dealer who first moves the goods in case of inter-State sales. Form E-II is issued by the second or subsequent transferor of such goods.

However, it shall not be necessary to furnish Form C in respect of a subsequent sale of goods if,-

(a) the sale or purchase of such goods is, exempt from tax generally or is subject to tax lower than 3%, under the sales tax law of the appropriate State and

(b) the dealer effecting such subsequent sale proves to the satisfaction of the prescribed authority that such sale is of the nature referred to in this subsection.

The concept of subsequent sales and the certificates to be furnished can be better understood with the following example:-

Example: A of Gujarat sells the goods to B of Haryana. As per the contract, A was required to deliver the goods in Odisha. For this purpose, A dispatches the goods from Gujarat to Odisha. During the movement of goods, B sells the goods by transfer of documents of title to the goods, to C of Bihar who in turn sells them to D of Odisha during such movement. D ultimately takes the delivery of the goods. Here, all the four dealers are registered dealers.

Levy of CST in case subsequent sales is taxable: If subsequent sale is made to an unregistered dealer or if necessary certificates/declaration are not furnished, the
subsequent sale would become taxable. Levy and collection of CST, in such cases, would be in the following States:-

(a) **Where such subsequent sale has been effected by a registered dealer:**
   State in which the registered dealer obtains or could have obtained Form C from the sales tax authorities, in other words, the State in which he is registered.

(b) **Where such subsequent sale has been effected by an unregistered dealer:** State from which such subsequent sale has been effected [Proviso to section 9(1)].

**Example:** Ram of Gujarat sells the goods to Babu of Haryana (a dealer registered in Haryana). As per the contract, Ram was required to deliver the goods in Bihar. For this purpose, Ram despatches the goods from Gujarat to Bihar and obtains Form C from Babu. During the movement of goods, Babu sells the goods by transfer of documents of title to the goods, to Charan of Bihar, an unregistered dealer who ultimately takes the delivery of the goods.

III. **No CST on sale to foreign missions/UN etc.** [Section 6(3)]

No CST is payable on sale of any goods made by a dealer, in the course of inter-State trade or commerce, to any official or personnel/consular or diplomatic agent of:

(i) any foreign diplomatic mission or consulate in India or

(ii) the United Nations or any other similar international body
entitled to privileges under any convention or agreement to which India is a party or under any law for the time being in force if such official, personnel, consular or diplomatic agent, as the case may be, has purchased such goods for himself or for the purposes of such mission, consulate, United Nations or other body.

However, aforesaid exemption is available only if the dealer selling such goods furnishes to the prescribed authority Form J obtained from the official, personnel, consular or diplomatic agent.

4.15 Exemption from CST

Following exemptions may be granted from CST in case of sale to a registered dealer:-

(I) Exemption by notification granted by the State Government [Section 8(5)]: State Government can grant exemption, by issuing a notification in the Official Gazette, in respect of the inter-State sales effected from the State subject to the fulfilment of the following conditions:-

(a) State government is satisfied that such exemption is necessary in the public interest.
(b) Sale must be made to a registered dealer.
(c) The selling dealer must furnish Form C as obtained from the registered purchasing dealer.

(II) Exemption from CST to a sale to unit/developer in SEZ [Section 8(6), 8(7) & 8(8)]: A registered dealer in SEZ (unit in SEZ/developer of SEZ) can obtain goods from outside SEZ, for specified purposes, without payment of CST. Following conditions must be satisfied in order to claim the said exemption:-

1. Purposes for which unit/developer of SEZ may use the goods sold:
   (a) Unit in SEZ: for the purpose of setting up, operation, maintenance, manufacture, trading, production, processing, assembling, repairing, re-conditioning, re-engineering, packaging or for use as packing material or packing accessories in a unit located in any SEZ.
(b) Developer of SEZ: for the purpose of development, operation and maintenance of SEZ by developer.

2. Authorised unit/developer: The unit in SEZ must be authorised to establish such unit or developer of SEZ must be authorized to develop, operate and maintain such SEZ, by the authority specified by the Central Government in this behalf.

3. Sale to registered dealer: The goods must be sold to a unit/developer of SEZ who is a registered dealer.

4. Declaration to be furnished: The purchasing dealer has to submit a declaration in Form I.

5. Goods specified in the registration certificate: Goods should be of such class or classes of goods as specified in the Certificate of registration of the registered dealer.

### Special Economic Zone (SEZ)

A Special Economic Zone (SEZ) is a geographically bound zone where the economic laws relating to export and import are more liberal as compared to other parts of the country. These are like a separate island within the territory of India. SEZs are projected as duty free area for the purpose of trade, operations, duty, and tariffs. SEZ is considered to be a place outside India for all tax purpose. Within SEZs, a unit may be set-up for the manufacture of goods and other activities including processing, assembling, trading, repairing, reconditioning, making of gold/ silver, platinum jewellery etc. As per law, SEZ units are deemed to be outside the customs territory of India. Goods and services coming into SEZs from the domestic tariff area or DTA are treated as exports from India and goods and services rendered from the SEZ to the DTA are treated as imports into India.

### 4.16 Goods of special importance/declared goods

Article 286(3) empowers the Parliament to declare some goods as ‘goods of special importance’ and to impose restrictions and conditions with regard to power of the States pertaining to levy, rates and other incidence of tax on such goods. Thus, Parliament can restrict the power of States to tax such declared goods.

State Government cannot levy sales tax within the State on these goods exceeding 5%. If declared goods are sold inter-State, tax paid within the State is reimbursed to seller provided the goods are sold inter-State in the same form.

#### A. Declared goods/Goods of special importance

As per section 2(c) of the Central Sales Tax Act, 1956, “declared goods” means goods declared under section 14 to be of special importance in inter-State trade or commerce. The following is an illustrative list of goods declared under section 14 to be of special importance in inter-state trade and commerce and thus constituting “declared goods”:

(i) Cereals
(ii) Coal, including coke in all its forms, but excluding charcoal
(iii) Cotton, (indigenous or imported) in its unmanufactured state, whether ginned or unginned, baled, pressed or otherwise, but not including cotton waste
(iv) Cotton fabrics
(v) Cotton yarn, but not including cotton yarn waste
(vi) Crude oil
(vii) Hides and skins, whether in a raw or dressed state
(viii) Iron and steel
(ix) Jute
(x) Oilseeds
(xi) Pulses
(xii) Man-made fabrics.
(xiii) Sugar.
(xiv) Liquefied petroleum gas for domestic use

B. Restrictions imposed on the tax imposed on the declared goods

Section 15 lists the restrictions which are imposed on the sale of the declared goods. These restrictions are as follows:-

(i) Sales tax within the State not to exceed 5%

The tax payable under the sales tax law of a State in respect of any sale or purchase of such goods inside that State shall not exceed 5% of the sale or purchase price.

(ii) Sales tax imposed within the State if goods sold inter-State subsequently

If a tax is levied on sales or purchase of any declared goods inside a State and the same commodity is subsequently sold in the course of inter-State trade or commerce and is subjected to CST, the sales tax paid within the State realised previously in respect of the commodity is reimbursed. The said reimbursement is subjected to following conditions:-

(a) the tax on the inter-State sale has been actually paid. Thus, it will not be possible for the dealer to claim back the tax paid by him in respect of the goods which subsequently became the subject-matter of an inter-State sale, unless he has actually paid the inter-State tax. Similarly, if the inter-State sale of the goods is exempt from tax, reimbursement of tax paid on intra-State sale is not available.

(b) The inter-State sale of goods must be in the same form.

Note: The rates of taxes, wherever mentioned in the illustrations may not always be the actual rates prevalent during the period in question. They may be hypothetical rates assumed to explain the provisions of law with more clarity.
Learning objectives

After reading Unit- 5 of this Chapter, you will be able to understand:

- the basic concepts of VAT - what is VAT, how does it operate, what are its different variants, what are the different methods of computation thereof and what are its merits and demerits
- the design of VAT in Indian context – CENVAT, State - Level VAT and proposed GST
- Constitutional provisions relating to levy of State - Level VAT
- what are the different VAT rates and coverage of goods
- the concept of input tax and output tax
- the concept of input tax credit
- how to compute the VAT liability
- the provisions relating to Composition Scheme for small dealers
- the position of VAT vis a vis sales tax incentives
- the applicability of VAT on works contract, lease transactions and hire-purchase transactions
- the deficiencies in the existing State - Level VAT regime in India

5.1 Basic concepts of VAT

(1) What is VAT?: Value added tax (VAT), as the term suggests, is a tax on the value added to the commodity at each stage in production and distribution chain. It is a system to collect the tax on the value at the final or retail point of sale. VAT is a consumption tax because it is borne ultimately by the final consumer.

Let us try to understand the concept of VAT with the help of an example.

Suppose, for manufacturing a product A, the manufacturer purchases four types of commodities B, C, D and E and pays excise duty on all of them. When ultimately he sells his manufactured product A, on which he has to discharge his liability towards excise, the excise duty leviable on such product is on a tax base which includes excise duties paid by the manufacturer on products B, C, D and E. Thus, the final excise duty is a duty on duty, which increases the cost of production as well as the price of the final product.

However, under VAT, the excise duties paid on commodities B, C, D and E are allowed to be set-off from the final duty liability on product A. Thus, the manufacturer avoids payment of duty on duty and the cost of the product is reduced, ultimately benefitting the consumer.

The above example is a case of value added tax on manufacture. In the same way, there can be a value added tax in respect of trading in commodities also. In case of VAT on sales, the
various taxes paid on inputs purchased will be allowed as a credit and set off against the tax liability on the value of sales of the commodity. In the same way, one can think of a system of VAT dealing with input and output services. The individual systems of manufacturing, sales and services VAT are ultimately combined to form a grand system of VAT on goods and services known as Goods and Services Tax.

(2) Cascading of taxes: As seen in the above example, in first case (non VAT), tax is levied on tax i.e, tax leviable at each stage is chargeable on a value which includes the tax paid at earlier stage as there is no credit of tax paid at earlier stage. This is termed as cascading effect of taxes which leads to increase in cost of production. However, in the second case (VAT), tax is not levied on tax paid at earlier stage; it is levied only on the value added as credit of tax paid at earlier stages is allowed to be set off against the tax payable at the next stage. Thus, VAT helps in eliminating cascading of taxes.

(3) How VAT operates: Value Added Tax (VAT) is levied as a proportion of the value added at each stage of production or distribution (i.e., sales minus purchase) which is equivalent to wages plus interest, other costs and profits. To illustrate, a chart of transactions is given below:

Note: The rate of tax is assumed to be 12.5% on transactions relating to goods manufactured by A (i.e., on sales made by A, B and C).

For a manufacturer A, inputs are product X and product Y which are purchased from a primary producer. In practice, even these producers use inputs. For example, a farmer would use seeds, feeds, fertilizer, pesticides, etc. However, for this example, their VAT impact is not considered. B is a wholesaler and C is a retailer.

The inputs X and Y are purchased at ₹ 100 each on which tax is paid @ 12.5 % and 4% respectively. After adding wages, salaries and other manufacturing expenses to the cost of inputs, manufacturer A will also add his own profit. Assuming that after the addition of all these costs his sale price is ₹ 300, the gross tax (at the rate of 12.50%) would be
1.122 Indirect Taxes

र 37.50. As manufacturer A has already paid tax on र 200, he would get credit for this tax (i.e. र 12.50 + र 4 = र 16.50). Therefore, his net VAT liability would be र 21 only (र 37.50 minus र 16.50) and because of this, he would take the cost of his inputs to be only र 200.

Similarly, the sale price of र 400 fixed by wholesaler B would have net VAT liability of र 12.50 (र 50 - र 37.50) and the sales price of र 500 by retailer C would also have net VAT liability of र 12.50 (र 62.50 - र 50). Thus, VAT is collected at each stage of production and distribution process, and in principle, its entire burden falls on the final consumer, who does not get any tax credit. Hence, VAT is a broad-based tax covering the value added by each party to the commodity during the various stages of production and distribution.

(4) Variants of VAT

<table>
<thead>
<tr>
<th>Gross Product Variant</th>
<th>Income Variant</th>
<th>Consumption Variant</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Tax is levied on all sales and deduction for tax paid on inputs excluding capital goods is allowed.</td>
<td>• Tax is levied on all sales with set-off for tax paid on inputs and only depreciation on capital goods.</td>
<td>• Tax is levied on all sales with deduction for tax paid on all business inputs (including capital goods).</td>
</tr>
</tbody>
</table>

(a) Gross Product Variant: The gross product variant allows deductions for taxes paid on all purchases of raw materials and components, but no deduction is allowed for taxes paid on capital inputs.

(b) Income Variant: The income variant of VAT on the other hand allows for deductions on purchases of raw materials and components as well as depreciation on capital goods. This method provides incentives to classify purchases as current expenditure to claim set-off.

(c) Consumption Variant: This variant of VAT allows deduction for all business purchases including capital assets. Thus, gross investment is deductible in calculating value added. It neither distinguishes between capital and current expenditures nor specifies the life of assets or depreciation allowances for different assets.

The consumption variant of VAT is the most widely used variant of the VAT. Several countries of Europe and other continents have adopted this variant as it does not affect decisions regarding investment because the tax on capital goods is also available for set-off against the VAT liability. Hence, the system is tax neutral in respect of techniques of production (labour or capital-intensive). It also simplifies tax administration by obviating the need to distinguish between purchases of inputs and capital goods.

In practice, therefore, most countries use the consumption variant. Also, most VAT countries include many services in the tax base. Since the business gets set-off for the tax on services, it does not cause any cascading effect.

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(5) Methods of computation of tax

Methods of computation of VAT

- **Addition method**: Aggregating all the factor payments and profit.
- **Invoice method**: Deducting tax on inputs from tax on sales.
- **Cost subtraction method**: Deducting aggregate value of purchase exclusive of tax from the aggregate value of sales exclusive of tax.
- **Direct subtraction method**: Deducting aggregate value of purchase exclusive of tax from the aggregate value of sales exclusive of tax.
- **Intermediate subtraction method**: Deducting tax inclusive value of purchases from the sales and taxing difference between them.

- **Example**:

<table>
<thead>
<tr>
<th>Stage</th>
<th>Particulars</th>
<th>VAT Liability (A) [₹]</th>
<th>VAT Credit (B) [₹]</th>
<th>Tax paid to Government (A – B) [₹]</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Manufacturer/first seller in the State sells the goods to distributor for ₹ 1000. Rate of tax is 12.5%. Therefore, his tax liability will be ₹ 125. He will not get any VAT credit, being the first seller.</td>
<td>125</td>
<td>-</td>
<td>125</td>
</tr>
<tr>
<td>2.</td>
<td>Distributor sells the goods to a wholesale</td>
<td>150</td>
<td>125</td>
<td>25</td>
</tr>
</tbody>
</table>
1.124 Indirect Taxes

3. Wholesale dealer sells the goods to a retailer at say ₹ 1500. Here again, he will have to pay the tax on ₹ 1500. He will get credit of tax paid at earlier stage of ₹ 150. The tax payable by him will be ₹ 37.50.

4. Retailer sells the goods to consumers at say ₹ 2000. Here again, he will have to pay tax on ₹ 2000. He will get credit for tax paid earlier at ₹ 187.50. The tax payable by him will be ₹ 62.50.

<table>
<thead>
<tr>
<th></th>
<th>187.50</th>
<th>150</th>
<th>37.50</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>712.50</td>
<td>462.50</td>
<td>250</td>
</tr>
</tbody>
</table>

Thus, the Government will get tax on the final retail sale price of ₹ 2,000. However, the tax will be paid in installments at different stages. At each stage, tax liability is worked out on the sale price and credit is also given on the basis of tax charged in the purchase invoice. If the first seller is a manufacturer, he gets the credit of tax paid on raw materials, etc. which are used in the manufacturing.

From the above illustration, it is clear that under this method, tax credit cannot be claimed unless and until the purchase invoice is produced. As a result, in a chain, if at any stage the transaction is kept out of the books, still there is no loss of revenue. The Government can recover the full tax at the next stage. Thus, the possibility of tax evasion, if not entirely ruled out, is reduced to a minimum. However, proper measures are required to prevent the production of fake invoices to claim credit of tax paid at an earlier stage.

It is said that in this method, the beneficiary is the trade and industry because in the above example, the total tax collection at all the stages is ₹ 712.50 whereas tax received by the State is only ₹ 250.

(c) Cost subtraction method: Under this method, tax is charged only on the value added at each stage of the sale of goods. Since, the total value of goods sold is not taken into account, the question of grant of claim for set-off or tax credit does not arise. Further, under this method tax cannot be shown separately in invoice and tax liability can only be calculated periodically. Since, tax payable on a product is not known, end-use based exemption cannot be given under this method.

For imposing tax, 'value added' is simply taken as the difference between sales and purchases.

Tax is calculated by the formula $\frac{T \times R}{100 + R}$, where $T$ = Taxable turnover and $R$ = Rate of Tax.

This method is suitable for gross product variant.
Example:

<table>
<thead>
<tr>
<th>Stage</th>
<th>Particulars</th>
<th>Turnover for tax under VAT (₹)</th>
<th>Tax @ 12.50% (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>First seller sells the goods to a distributor at ₹ 1,125 inclusive of tax.</td>
<td>1,125</td>
<td>125</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>$(1125 \times 12.50) \div 100 + 12.50$</td>
</tr>
<tr>
<td>2.</td>
<td>Distributor sells the goods to a whole-seller at ₹ 1,350. Here, taxable turnover will be ₹ 1,350 - ₹ 1,125.</td>
<td>225</td>
<td>25</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>$(225 \times 12.50) \div 100 + 12.50$</td>
</tr>
<tr>
<td>3.</td>
<td>Wholesaler sells the goods to a retailer at say, Rs 1,687.50. Here, taxable turnover will be ₹ 1,687.50 - ₹ 1,350</td>
<td>337.50</td>
<td>37.50</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>$(337.50 \times 12.50) \div 100 + 12.50$</td>
</tr>
<tr>
<td>4.</td>
<td>Retailer selling the goods at say, ₹ 2250. Taxable turnover will be ₹ 2250 - ₹ 1687.50</td>
<td>562.50</td>
<td>62.50</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>$(562.50 \times 12.50) \div 100 + 12.50$</td>
</tr>
</tbody>
</table>

Thus, under this system also, tax is charged at each stage and the incidence of tax on the final sale price to the consumer remains the same as in the invoice method. However, this holds good till the time the same rate of tax is attracted on all inputs, including consumables and services, added at all the stages of production/distribution. If the rates are not common, then the final tax by the two methods may differ. This is explained through the examples given below.

Example:

<table>
<thead>
<tr>
<th>Invoice method</th>
<th>All inputs taxable at ONE rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Particulars</td>
<td>Invoice value [₹]</td>
</tr>
<tr>
<td>Inputs for A</td>
<td></td>
</tr>
<tr>
<td>Product X @ 12.50%</td>
<td>260</td>
</tr>
<tr>
<td>Product Y @ 12.50%</td>
<td>450</td>
</tr>
<tr>
<td>'A' sells goods to 'B'</td>
<td>710</td>
</tr>
<tr>
<td>'B' sells goods to 'C'</td>
<td>1125</td>
</tr>
<tr>
<td>'C' sells goods to 'D'</td>
<td>1800</td>
</tr>
<tr>
<td>'D' sells goods to 'E'</td>
<td>2250</td>
</tr>
<tr>
<td>FINAL</td>
<td>2700</td>
</tr>
</tbody>
</table>
### Subtraction method

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Invoice value [₹]</th>
<th>Purchase price [₹]</th>
<th>Value added [₹]</th>
<th>VAT @ 12.50% [₹]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inputs for A</td>
<td>710</td>
<td>--</td>
<td>--</td>
<td>79</td>
</tr>
<tr>
<td>‘A’ to ‘B’</td>
<td>1125</td>
<td>710</td>
<td>415</td>
<td>46</td>
</tr>
<tr>
<td>‘B’ to ‘C’</td>
<td>1800</td>
<td>1125</td>
<td>675</td>
<td>75</td>
</tr>
<tr>
<td>‘C’ to ‘D’</td>
<td>2250</td>
<td>1800</td>
<td>450</td>
<td>50</td>
</tr>
<tr>
<td>‘D’ to ‘E’</td>
<td>2700</td>
<td>2250</td>
<td>450</td>
<td>50</td>
</tr>
<tr>
<td>FINAL</td>
<td>2700</td>
<td>--</td>
<td>--</td>
<td>300</td>
</tr>
</tbody>
</table>

### Invoice method

#### Inputs taxable at DIFFERENT rates

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Invoice [₹]</th>
<th>Material Value [₹]</th>
<th>VAT [₹]</th>
<th>Input tax credit [₹]</th>
<th>Net VAT paid [₹]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inputs for A</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product X @ 4%</td>
<td>260</td>
<td>250</td>
<td>10</td>
<td>--</td>
<td>10</td>
</tr>
<tr>
<td>Product Y @ 12.5%</td>
<td>450</td>
<td>400</td>
<td>50</td>
<td>--</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>----</td>
<td>----</td>
<td>--------</td>
<td>---------------------</td>
<td>-----------------</td>
</tr>
<tr>
<td>‘A’ sells goods to ‘B’</td>
<td>1125</td>
<td>1000</td>
<td>125</td>
<td>60</td>
<td>65</td>
</tr>
<tr>
<td>‘B’ sells goods to ‘C’</td>
<td>1800</td>
<td>1600</td>
<td>200</td>
<td>125</td>
<td>75</td>
</tr>
<tr>
<td>‘C’ sells goods to ‘D’</td>
<td>2250</td>
<td>2000</td>
<td>250</td>
<td>200</td>
<td>50</td>
</tr>
<tr>
<td>‘D’ sells goods to ‘E’</td>
<td>2700</td>
<td>2400</td>
<td>300</td>
<td>250</td>
<td>50</td>
</tr>
<tr>
<td>FINAL</td>
<td>2700</td>
<td>2400</td>
<td>300</td>
<td>--</td>
<td>300</td>
</tr>
</tbody>
</table>

### Subtraction method

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Invoice [₹]</th>
<th>Purchase Price [₹]</th>
<th>Value Added [₹]</th>
<th>VAT @ 12.50% [₹]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inputs for A</td>
<td>710</td>
<td>--</td>
<td>--</td>
<td>60</td>
</tr>
<tr>
<td>‘A’ to ‘B’</td>
<td>1125</td>
<td>710</td>
<td>415</td>
<td>46</td>
</tr>
<tr>
<td>‘B’ to ‘C’</td>
<td>1800</td>
<td>1125</td>
<td>675</td>
<td>75</td>
</tr>
<tr>
<td>‘C’ to ‘D’</td>
<td>2250</td>
<td>1800</td>
<td>450</td>
<td>50</td>
</tr>
<tr>
<td>‘D’ to ‘E’</td>
<td>2700</td>
<td>2250</td>
<td>450</td>
<td>50</td>
</tr>
<tr>
<td>FINAL</td>
<td>2700</td>
<td>--</td>
<td>--</td>
<td>281</td>
</tr>
</tbody>
</table>
Thus, on the same consumer price of ₹ 2700, under invoice method, VAT works out to be ₹ 300 whereas under the subtraction method it works out to be ₹ 281. Therefore, this method is not considered as a good method.

(6) Merits and Demerits of VAT

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Merits</th>
<th>Demerits</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Reduced tax evasion: Even if tax is evaded at one stage, the transaction gets caught in next stage of production or distribution.</td>
<td>Distortions in case of exemptions/concessions: The merits accrue in full measure only where there is one rate of VAT and the same applies to all commodities without any question of exemptions whatsoever. Once concessions like differential rates of VAT, composition schemes, exemption schemes, exempted category of goods etc. are built into the system, distortions are bound to occur.</td>
</tr>
<tr>
<td>2.</td>
<td>Increased tax compliance: VAT acts as a self-policing mechanism as the buyer can get credit of tax paid only if the seller issues the invoice showing tax and thus, the buyer insists on getting the invoice from the seller, thereby acting as a police for the seller.</td>
<td>Increased compliance cost: The detailed accounting and the paper work required for complying with the VAT system increases the compliance cost which may not always commensurate with the benefit to traders and small firms.</td>
</tr>
<tr>
<td>3.</td>
<td>Certainty: VAT brings certainty owing to is simple tax structure and minimum variations.</td>
<td>Increased working capital requirements: Since tax is to be imposed or paid at various stages and not on last stage, it increases the working capital requirements and the interest burden on the same. Thus, it is considered to be non-beneficial in comparison with single stage-last point taxation system.</td>
</tr>
<tr>
<td>4.</td>
<td>Transparency: As the tax charged has to be shown clearly in the invoice, the system becomes transparent with no hidden taxes.</td>
<td>Consumption favoured over production: Since, VAT is a consumption based tax, it is collected by the State consuming the goods. Thus, States where consumption is higher tend to get more revenue than States where production is higher.</td>
</tr>
</tbody>
</table>
### 5. Indirect Taxes

<table>
<thead>
<tr>
<th></th>
<th><strong>Cheaper exports:</strong> Exports get cheaper as taxes paid at earlier stages could be availed as credit or refunded in cash.</th>
<th><strong>Tax evasion through bogus invoices:</strong> Since input tax credit can be availed on the basis of invoices, dealers try to claim tax credit on the basis of fake invoices – where no purchases has been made - thereby causing loss of revenue to the exchequer.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Better accounting systems:</strong> Since the tax paid at the earlier stage is to be received back, the system promotes better accounting systems.</td>
<td><strong>Regressive tax:</strong> Burden of VAT falls disproportionately on the poor since the poor are likely to spend more of their income than the relatively rich person.</td>
</tr>
<tr>
<td></td>
<td><strong>Neutrality:</strong> Since tax credit of both inputs and capital goods is available, there is no distinction between labor intensive and capital intensive industries.</td>
<td></td>
</tr>
</tbody>
</table>

### 5.2 VAT in Indian context

![Diagram of VAT in India](image)

(1) **CENVAT:** In India, VAT was introduced for the first time in the year 1986 as Modified VAT (MODVAT) in case of manufacture of goods. The same was subsequently changed to Central VAT (CENVAT) in the year 2000. VAT was introduced in case of services in the year 2002 and the same was subsequently integrated with CENVAT in the year 2004. Thus, excise duty paid on inputs/capital goods and service tax paid on input services could be availed as credit for being set off against the manufacturer’s excise duty liability or a service provider’s
service tax liability\(^1\).

\[\text{(2) State-Level VAT:}\] After the introduction of VAT in the area of manufacture and services, a need arose to introduce a similar system in the area of sales tax as the erstwhile sales tax regime had become highly complex due to multiple taxes, cascading effect, varying rates of sales tax on different commodities in different States leading to unhealthy competition among the States often resulting in counter-productive situations.

It is in this background that attempts were made to introduce a harmonious VAT in the States. In view of the Constitutional constraints (Central Government is empowered to levy tax on goods and services while tax on sales is a State subject), CENVAT could not be extended to sales tax. Therefore, the Central Government constituted an Empowered Committee of State Finance Ministers chaired by Dr. Asim Dasgupta to consider introduction of State-Level VAT. Finally, State-Level VAT was introduced on 01.04.2005 by majority of the States, though few States had already implemented it by that time.

State-Level VAT replaced the erstwhile sales tax system and marked a significant step forward in the reform of domestic trade taxes in India. After overcoming the initial difficulties, all the States and Union Territories implemented VAT. Trade and industry also responded well to the reform. The rate of growth of tax revenue nearly doubled from the average annual rate of growth in the pre-VAT five year period after the introduction of VAT.

Introduction of VAT in the States has been a more challenging exercise in a federal country like India, where each State, in terms of Constitutional provisions, is sovereign in levying and collecting State taxes. State-Level VAT has addressed the distortions and complexities associated with the levy of tax at the first point of sale under the erstwhile system and resulted in a major simplification of the rate structure and broadening of the tax base.

Thus, at present, VAT is operational in India as CENVAT (central level) in case of manufacture of goods and rendition of services and as State-Level VAT in the case of sale of goods.

\textbf{White Paper on State-Level VAT in India:} The Empowered Committee of State Finance Ministers brought out a White paper on State-Level VAT in India on 17.01.2005, which provided a base for the preparation of various State VAT legislations. Considering that VAT is a State subject, the States had freedom for making appropriate variations consistent with the basic design as agreed upon at the Empowered Committee. Broadly, the White Paper consists of the following:

(a) Justification of VAT and Background
(b) Design of State-Level VAT
(c) Steps taken by the States

All the State VAT legislations passed by the States have incorporated the principles of State-Level VAT as contained in the White Paper. However, each State has made changes as per its needs.

\(^1\) The concept of CENVAT credit available on goods and services has been discussed in Chapter-7 of this Study Material.
No model law for all States: Though the basic concepts of State-Level VAT are same in all States, tax on sales being a State subject, the provisions of VAT Acts of different States differ from State to State. For instance, provisions in respect of credit allowable, credit of tax on capital goods and the like are not uniform. Further, definitions of terms like ‘business’, ‘sale’, ‘sale price’, ‘goods’, ‘dealer’, ‘turnover’, ‘input tax’ etc. are also not uniform. Though as per the design of State-Level VAT set out in the White Paper, tax rates were expected to be uniform broadly, the tax rates on various articles differ from State to State.

The concepts relating to VAT dealt in subsequent pages of this Unit are based on the principles laid down by the White Paper on State-Level VAT. It may be noted that the discussion in this Unit is not based on the provisions of any particular State VAT Act.

(3) Goods and Service Tax: Despite the introduction of value added tax in India - at the Central level in the form of CENVAT and at the State level in the form of State VAT - its application has remained piecemeal and fragmented on account of the following reasons:

(a) Problems relating to distinguishing between goods and services have been a major cause of concern in service taxation as the distinction between the two is often blurred.

(b) Non-inclusion of several State and local levies in State VAT such as luxury tax, entertainment tax, etc.

(c) Cascading effect of taxes as CENVAT on the goods remains included in the value of goods taxed under State VAT.

(d) No integration of VAT on goods with tax on services at the State level.

(e) Continued imposition of the central sales tax (CST), which is non-vattable, leads to cascading effect thereby adding to the cost of goods.

With a view to mitigate such problems, the then Finance minister, Mr. P. Chidambaram, in Union Budget 2006-07 proposed the roll out of India’s most ambitious indirect tax reform namely, Goods and Service Tax (GST). GST seeks to attain a comprehensive and harmonized tax structure in a federal State like India. It is aimed at creating a common domestic market, removing multiplicity of taxes, eliminating cascading effect of tax on tax, making the prices of the Indian products competitive and, above all, benefiting the end consumers. A dual model has been proposed for GST in India so that both Central and State Governments can collect taxes to raise resources to fulfill their sovereign obligations/ duties. GST will subsume most of the indirect taxes being levied in India including central sales tax (CST).

GST would integrate goods and service taxes for the purpose of set-off relief. Simultaneous introduction of GST at the State level will ensure that both the cascading effects of CENVAT and service tax are removed with set-off, and a continuous chain of set-off from the original producer’s point and service provider’s point up to the retailer’s level is established which reduces the burden of all cascading effects. However, for the GST to be introduced at the State level, it is essential that the States should be given the power to levy tax on services. This power of levy of service taxes has so long been only with the Centre. A Constitutional Amendment is proposed for giving this power to the States as well.
Though, introduction of GST in India is a very arduous task as it requires amendment of the Constitution of India and consensus between Central and States Governments on variety of issues like rates, basic threshold, exemptions, classification, administration; it is expected to give a major relief to industry, trade, agriculture and consumers through a comprehensive and wider coverage of input tax set-off and service tax set-off, subsuming of multiple taxes and phasing out of CST.

5.3 Constitutional provisions relating to State-Level VAT

As learned before, tax on intra-state sale or purchase of goods is a State subject. Therefore, State Governments levy VAT under the authority of Entry 54 of the State List which reads as under:

ENTRY 54 OF STATE LIST

Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A* of Union List.

[*Central Government levies CST by virtue of Entry 92A of the Union List]*

It is important to note that State Governments are not empowered to levy tax on intra-state sale or purchase of newspapers. You may also recollect that inter-state sale or purchase of newspapers is also not liable to central sales tax. Thus, sale or purchase of newspapers, whether inter-state or intra-state, is not liable to any type of tax.

(1) **What is tax on sale or purchase of goods?**: Clause (29A) of the Article 366 of the Constitution defines the term "tax on sale or purchase of goods". The definition is an inclusive one and it lays down six specific instances of deemed sale i.e., cases which are not sales in traditional sense but have been deemed to be sales for the purpose of leviability of CST/VAT. These deemed sales encompass elements of both goods as well as services. The goods portion is chargeable to CST/VAT and on services portion, service tax is imposed. This aspect has been discussed in detail in Unit 4 of this Chapter.

(2) **What is sale?**: Sale means-

(a) any transfer of property in goods by one person to another for cash or deferred payment or for any other valuable consideration; and

(b) includes “deemed sales” transactions under Article 366(29A) of the Constitution of India; but

(c) does not include a mortgage or hypothecation of, or a charge or pledge on, goods.

(3) **What are goods?**:

(i) **As per Sale of Goods Act, 1930**: As per section 2(7) of the Sales of Goods Act, 1930, ‘goods’ means-
1.132 Indirect Taxes

(a) every kind of movable property other than actionable claims and money and
(b) includes stocks and shares, growing crops, grass and things attached to and
forming part of the land, which are agreed to be severed before sale or under the
contract of sale.

(ii) As per Central Sales Tax Act, 1956: Section 2(d) of CST Act defines that 'goods'
includes all materials, articles, commodities and all kinds of movable property, but does
not include newspapers, actionable claims, stocks, shares and securities.
Though each State has its own definition of 'goods' but broadly, the definitions are similar
to the definition provided under the CST Act.

The following points merit consideration in this regard:

- Goods may be tangible (like computer, pen, pencil etc.) as well as intangible (like patent,
copyright).
- Goods include all kinds of movable property, but not newspapers, actionable claims,
stocks, shares and securities.
- Plant and machinery erected at site, being immovable property, is not goods.
- Electricity is goods but lottery ticket, being actionable claim, is not goods.
- Software (branded as well as unbranded) is goods.

5.4 VAT rates and coverage of goods

(1) VAT rates: In order to do away with the demerits of multiple rates prevalent under sales
tax regime, minimum number of rates were recommended in the White Paper. However, States
have deviated from the prescribed rates. The prevalent common tax rates are:

- 0% Rate of natural and unprocessed products in unorganised sector (e.g.
  firewood, plants)- items which are legally barred from taxation and items which have social
  implications (e.g. national flag, salt).
- 1% Rate of precious stones, bullion, gold and silver ornaments etc.
- 5% Rate of items of basic necessities like medicines and drugs, all
  agricultural and industrial inputs, declared goods & capital
  goods. Originally White Paper had proposed 4% rate on such
  goods but many States have subsequently increased this rate
to 5%.
  Rate of declared goods has also been increased to 5% by many
  States after amendment of CST Act w.e.f. 08.04.2011.
- 12.5%/13.5% Rate of all other goods not chargeable to any of the above rates.
  Originally White Paper had proposed 12.5% rate as the revenue
  neutral rate but most of the States have subsequently increased
  this rate to 13.5%.

[Fig. 6]
Largely, all States follow the above rate structure, but still there are many variations.

(2) **Coverage of goods under VAT:** As per the White Paper, generally, all the goods, including declared goods will be covered under VAT and get the benefit of input tax credit.

The few goods which will be outside VAT will be liquor, lottery tickets, petrol, diesel, aviation turbine fuel and other motor spirit since their prices are not fully market determined. Though sale of liquor, petrol, diesel and aviation turbine fuel (ATF) is charged to tax under VAT laws in many States, taxes paid on them are not allowed as credit to the buyer. In other words, they are outside the VAT chain. ATF and petroleum products are liable to minimum 20% VAT in most of the States.

### 5.5 Input tax and output tax

**Input tax**

It is the tax paid or payable in the course of business on purchases of any goods made from a registered dealer of the state.

**Output tax**

It is the tax charged or chargeable under the Act, by a registered dealer for the sale of goods in the course of business.

In simple words input tax is the tax paid by a dealer on local purchases of business inputs, which include goods that he purchases for resale, raw materials, capital goods as well as other inputs for being used directly or indirectly in his business. Output tax is the tax charged by a dealer on his sales that are subject to tax.
1.134 Indirect Taxes

Example: ‘A’ purchases inputs valuing ₹ 1,000 chargeable to VAT @ 12.5%. In this case, ₹ 125 paid by ‘A’ as VAT is input tax for ‘A’.

When ‘A’ sells goods manufactured from such inputs to ‘B’ at ₹ 2,000 chargeable to VAT @ 12.5%, ₹ 250 collected by ‘A’ from ‘B’ is the output tax for ‘A’ while the same is input tax for ‘B’.

Thus, it is clear that CST cannot be an input tax as it is leviable on purchases made by the dealer from outside the State. Likewise, custom duty paid on imported inputs cannot also be an input tax as it is leviable on purchases made by the dealer from outside the country.

5.6 Input tax credit (ITC)

The essence of VAT is in providing set-off for the tax paid earlier, and this is given effect through the concept of input tax credit/rebate. Input tax credit in relation to any period means setting off the amount of input tax by a registered dealer against the amount of his output tax. Thus, CST paid on purchases made from outside the State cannot be claimed as input tax credit.

(1) CST is not Vatable: Let us try to understand why CST is not Vatable with the help of the following example:

Example: A dealer of Karnataka purchases goods from another dealer of Maharashtra. The Maharashtra dealer charges CST @ 2% on this sale against the ‘C’ form produced by the dealer of Karnataka. The tax is deposited in the treasury of Maharashtra and thus, forms part of Maharashtra’s revenue. Though its name is central sales tax but the Central Government does not get any part of this revenue and it is totally a revenue receipt of the selling state. The Karnataka dealer later sells these goods in the State of Karnataka to any other dealer or consumer and collects VAT on the same.

Now the question arises whether the Karnataka dealer can claim input tax credit of the CST paid by him against his VAT liability. The answer is no as Karnataka (purchasing State) would not allow set off of a tax paid in Maharashtra (another State).

However, when liability of CST arises on an inter-state sale, input tax credit can be used for set off as the revenue in this case does not go to any other State.

CST leads to cascading of taxes: India has a purely unbalanced State wise economy as only some of the States are manufacturing States while majority of them are consumer states. Manufacturing States generate considerable revenues from CST. When goods purchased from manufacturing States (with CST imposed on them) are resold in these States, the tax liability of non-manufacturing States becomes very high on account of VAT and CST.

(2) Coverage of ITC: Input tax credit is available in respect of input tax paid on purchase of inputs and capital goods.

(i) Inputs: ITC is allowed to a registered dealer for purchase of any goods made within the State from a dealer holding a valid certificate of registration under the Act. Further, the ITC is given to both manufacturers and traders for purchase of inputs/supplies meant for both sale within the State as well as to other States, irrespective of when these will be utilized/sold.
(ii) Capital goods:

(a) Meaning of capital goods: Capital goods include plant and machinery, furniture, fixture, electrical installations, vehicles etc. (other than raw material) purchased by the registered dealer or manufactured by the registered dealer himself. Input tax paid on purchase of capital goods as also on the raw materials used for manufacturing the capital goods, is eligible for ITC.

(b) Need of ITC for input tax paid on capital goods: By extending ITC on capital goods, the cascading effect of taxes (tax on tax) is avoided. If VAT paid on capital goods is allowed as ITC, deprecation is claimed on the value excluding VAT. This reduces the cost and ultimately, the selling price.

(c) Policy in White Paper: ITC on capital goods is also available for traders and manufacturers. Tax credit on capital goods can be adjusted over a maximum of 36 equal monthly installments. The States can, at their option, reduce the number of installments.

For instance, in Maharashtra full ITC on capital goods is available in the month of purchases itself. However, if the capital asset is sold within the period of 36 months, proportionate ITC is withdrawn.

There is a negative list of capital goods (on the basis of principles already decided by the Empowered Committee) not eligible for input tax credit.

The allowable set off on capital goods is part of normal set off. The dealer can adjust this set off against his other VAT liability.

(3) Purchases eligible for availing input tax credit: For the purpose of claiming ITC, the taxable goods should be purchased for any one of the following purposes-

(i) for sale/resale within the State;
(ii) for sale to other parts of India in the course of inter-State trade or commerce;
(iii) to be used as-
   (a) containers or packing materials;
   (b) raw materials; or
   (c) consumable stores, required for the purpose of manufacture of taxable goods or in the packing of such manufactured goods intended for sale in the State or in the course of inter-State trade or commerce;
(iv) for being used in the execution of a works contract;
(v) to be used as capital goods required for the purpose of manufacture or resale of taxable goods;
(vi) to be used as
   (a) raw materials;
1.136  Indirect Taxes

(b) capital goods;
(c) consumable stores and
(d) packing materials/containers
for manufacturing/packing goods to be sold in the course of export out of the territory of India;
(vii) for making zero-rated sales other than those referred to in clause (vi) above.

(4) Purchases not eligible for input tax credit:  ITC may not be allowed in the following circumstances-
(i) purchases from unregistered dealers [as he cannot charge VAT];
(ii) purchases from registered dealer who opts for composition scheme [Concepts relating to Composition Scheme have been discussed under Heading 5.8 of this Unit.]
(iii) purchase of goods as may be notified by the State Government;
(iv) purchase of goods where the purchase invoice is not available with the claimant or there is evidence that the same has not been issued by the registered selling dealer from whom the goods are purported to have been purchased;
(v) purchase of goods where invoice does not show the amount of tax separately;
(vi) purchase of goods for being utilized in the manufacture of exempted goods or purchase of goods when the sales are exempt [However, in some States partial input tax credit is available even when sales are exempt];
(vii) purchase of goods for personal use/consumption or to be provided free of charge as gifts, free samples [partial credit is available in the State of Maharashtra];
(viii) purchase of goods like motor vehicles, toilet articles, furniture etc. which are not used in relation to production of goods or held for sale/resale;
(ix) goods imported from outside the territory of India;
(x) goods purchased from other States viz. inter-state purchases.

Some special aspects:
- **One to one co-relation not required:** VAT does not require bill to bill co-relation between input and output. It is not necessary to ensure that ITC of only those inputs which are actually utilized in the manufacture of the output is being set off against the output tax liability. ITC can be utilized for payment of VAT on any output without waiting for the input to be actually consumed/sold. Thus, ITC is available as soon as inputs/capital goods are purchased [In case of capital goods, some States allow ITC in specified installments].
- **ITC in case of exports and inter-state sale:** Whereas input tax credit is available on goods meant for export or inter-state sale, the same cannot be availed on goods purchased from outside India or outside the State.
• **ITC allowed only if VAT paid by the seller:** Input tax credit is allowed only to the extent of tax received by the State Government from the seller. Therefore, the purchasing dealer, desirous of claiming set off, should also look into the credentials of the vendor so as to be sure that he will get the set off of tax paid to him.

• **Proportionate ITC in case of goods partially used for taxable goods:** As learned before, ITC is allowed only if the goods are used for manufacture etc. of taxable goods and no credit is allowed for goods used in manufacture of tax free/exempted goods. Taxable goods are other than tax-free goods.

However, where the purchased goods are used partially for the purpose of taxable goods, input tax credit is allowed proportionate to the extent the purchases are used for the purposes of taxable goods. Thus, credit relating to the goods used in manufacture of exempted goods has to be reversed.

**Example:** A manufacturer purchases 50 kg of raw material worth ₹10,000 and pays ₹1250 VAT on it. While 20 kg of the raw material is used for manufacture of taxable goods, the remaining is used for exempted goods. Thus, ITC of ₹500 (ITC proportionate to the raw material being used in manufacture of taxable goods) can only be allowed.

• **Stock transfer:** Transfer of goods from one branch to another or consignment transfers are not liable to VAT or CST as they do not involve sale. Whereas entire ITC is allowed in case of transfer of goods within the State, partial ITC is allowed in case of inter-state transfer of goods. The tax paid in excess of 2% on

(i) inputs used in the manufacture of finished goods which are stock transferred; or

(ii) purchase of goods which are stock transferred

to another State is available as input tax credit.

**Example:** If goods worth ₹2,000 chargeable to VAT @ 12.5% are stock transferred to a branch in another State, then ₹40 [2% of ₹2,000] would be retained and balance ₹210 would be available as credit.

• **Exempted goods v. zero rated goods:** In case of zero rated sales, VAT is not payable on final products in certain specified circumstances but input tax credit can be availed on the inputs. For example, exports are zero rated. In such a case, ITC can be utilized for payment of VAT on taxable goods sold within India. If the exports of the dealer are more than his taxable sale within India, he can get refund of the ITC available with him.

However, if goods are exempted goods, then ITC on inputs used in the manufacture thereof is not allowed.
(5) **Utilization of ITC:** ITC of a period may be used as under-

- ITC may be used for payment of VAT on intra-state sales made during the period.
- If balance is available, ITC may be used for payment of CST payable on inter-state sales made during the period.
- Carried forward to the next period.

[Fig. 9]

(6) **Carrying over of tax credit:** As explained above, input tax credit is first to be utilized for payment of VAT. The excess credit can be then adjusted against the CST for the said period. After the adjustment of VAT and CST, excess credit, if any, will be carried over to the end of the next year. If there is any excess unadjusted input tax credit at the second year, then the same will be eligible for refund. However, some States grant refund at the end of the first financial year itself.

(7) **Refund of input tax / exemption from input tax:**
- **Refund within three months in case of exports:** The White Paper provides for the grant of refund of input tax paid if the goods are exported out of the country. Under the basic design of the White Paper, this refund is to be granted within a period of 3 months from the end of the period in which the transaction for export took place.
- **Exemption/refund to SEZ and EOU Units:** Units located in Special Economic Zone (SEZ) and Export Oriented Units (EOU) are granted either exemption from payment of input tax or refund of the input tax paid within three months. State Governments may reduce the time period of 3 months.
- **Reimbursement of tax to UNO and Embassies:** In some of the States, the specialized agencies of the United Nations Organization and Consulates and also Embassies of any other countries located in the State get the reimbursement of tax paid subject to fulfillment of conditions.

(8) **Refund of special CVD paid on goods imported by a trader:** Manufacturers in India are allowed to avail CENVAT credit of special CVD paid on imported goods used in the manufacture of final products. The special CVD is leviable @ 4% on imported goods in lieu of VAT [Special CVD has been discussed in detail in Unit 3 of this Chapter].

However, a trader importing goods for further sale in India can claim refund of the special CVD paid by him, if he -

- charges VAT on further sale of such imported goods and
5.7 VAT liability

Value Added Tax (VAT) is based on the value addition to the goods, and the related VAT liability of the dealer is calculated by deducting input tax credit from output tax payable i.e., tax collected on sales during the payment period (say, a month).

Subject to the provisions relating to credit for input tax, the net tax payable by a taxable person for a tax period can be calculated on the basis of the following formula:

Net tax payable = A – B, where

A = Total of the tax payable in respect of taxable supplies made by the taxable person during the tax period and

B = Total input tax credit allowed to the taxable person for the tax period.

Example: A is a trader selling raw materials to a manufacturer of finished products. He imports his stock-in-trade as well as purchases the same in the local markets and sells the entire product to B.

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>A’s cost of imported materials (A has deposited ₹ 1250 duty on the above. Since, this is not a State VAT it will form cost of the input)</td>
<td>11,250</td>
</tr>
<tr>
<td>(ii)</td>
<td>A’s cost of local materials (VAT charged by local suppliers ₹ 2,500. Since the credit of this would be available, it will not be included in cost of input)</td>
<td>20,000</td>
</tr>
<tr>
<td>(iii)</td>
<td>Other expenditure (such as for storage, transport, etc.) incurred and profit earned by A</td>
<td>8,750</td>
</tr>
<tr>
<td>(iv)</td>
<td>Sale price of goods</td>
<td>40,000</td>
</tr>
<tr>
<td>(v)</td>
<td>VAT on the above @ 12.50%</td>
<td>5,000</td>
</tr>
<tr>
<td>(vi)</td>
<td>Invoice value charged by A to the manufacturer, B</td>
<td>45,000</td>
</tr>
</tbody>
</table>
A’s VAT liability will be determined as under:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>B’s cost of raw materials (VAT available set off ₹ 5,000)</td>
<td>40,000</td>
</tr>
<tr>
<td>(ii)</td>
<td>B’s cost of other materials</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Local Purchases (VAT charged on the above ₹ 2,500)</td>
<td>20,000</td>
</tr>
<tr>
<td>(iii)</td>
<td>Inter-State Purchases* (CST paid ₹ 400)</td>
<td>10,400</td>
</tr>
<tr>
<td>(iv)</td>
<td>Manufacturing and other expenses incurred and profit earned by B</td>
<td>29,600</td>
</tr>
<tr>
<td>(v)</td>
<td>Sale price of finished product</td>
<td></td>
</tr>
<tr>
<td>(vi)</td>
<td>VAT on the above @ 12.5%</td>
<td>12,500</td>
</tr>
<tr>
<td></td>
<td>Invoice value charged by B to the wholesaler, C</td>
<td>1,12,500</td>
</tr>
</tbody>
</table>

*Credit / set off for tax paid on inter-State purchases (inputs) is not allowed.

II. B’s liability for VAT

<table>
<thead>
<tr>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on the sale price</td>
<td>12,500</td>
</tr>
<tr>
<td>Less: Set-off of VAT paid on purchases</td>
<td></td>
</tr>
<tr>
<td>To A</td>
<td>5,000</td>
</tr>
<tr>
<td>To other suppliers</td>
<td>2,500</td>
</tr>
<tr>
<td>Net Tax Payable</td>
<td>5,000</td>
</tr>
</tbody>
</table>

When C, after repacking the goods into other packing boxes, sells the finished product to a retailer, following would be the position:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>C’s cost of goods (VAT paid available as set off ₹ 12,500)</td>
<td>1,00,000</td>
</tr>
<tr>
<td>(ii)</td>
<td>Cost of packing material (VAT charged on the above ₹ 250)</td>
<td>2,000</td>
</tr>
<tr>
<td>(iii)</td>
<td>Expenses incurred and profit earned by C</td>
<td>18,000</td>
</tr>
<tr>
<td>(iv)</td>
<td>Sale price of goods</td>
<td>1,20,000</td>
</tr>
<tr>
<td>(v)</td>
<td>VAT on the above @ 12.5%</td>
<td>15,000</td>
</tr>
<tr>
<td>(vi)</td>
<td>Invoice value charged by C to D, a retailer</td>
<td>1,35,000</td>
</tr>
</tbody>
</table>
III. C’s liability for VAT

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on the sale price</td>
<td>15,000</td>
</tr>
<tr>
<td>Less: Set-off of VAT paid</td>
<td></td>
</tr>
<tr>
<td>To B</td>
<td>12,500</td>
</tr>
<tr>
<td>To other suppliers</td>
<td>250</td>
</tr>
<tr>
<td><strong>Net Tax payable</strong></td>
<td><strong>2,250</strong></td>
</tr>
</tbody>
</table>

When D sells the goods to the consumers, the position would be as under:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>D’s cost of goods (VAT paid available as set off ₹ 15,000)</td>
<td>1,20,000</td>
</tr>
<tr>
<td>(iii)</td>
<td>Expenses incurred and profit earned by D</td>
<td>20,000</td>
</tr>
<tr>
<td>(iv)</td>
<td>Sale price of goods</td>
<td>1,40,000</td>
</tr>
<tr>
<td>(v)</td>
<td>VAT on the above @ 12.5%</td>
<td>17,500</td>
</tr>
<tr>
<td>(vi)</td>
<td>Invoice value charged by D to the consumers</td>
<td>1,57,500</td>
</tr>
</tbody>
</table>

IV. D’s liability for VAT

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on the sale price</td>
<td>17,500</td>
</tr>
<tr>
<td>Less: Set-off of VAT paid to C</td>
<td>15,000</td>
</tr>
<tr>
<td><strong>Net Tax Payable</strong></td>
<td><strong>2,500</strong></td>
</tr>
</tbody>
</table>

Total recovery

It would be seen from the above illustration that VAT is collected at each stage of production or distribution till the goods reach the hands of ultimate consumer. The revenue collection to the department is provided in the table given below:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Paid by suppliers selling raw materials to A</td>
<td>2,500</td>
</tr>
<tr>
<td>(ii)</td>
<td>Net tax paid by A on his sales to B</td>
<td>2,500</td>
</tr>
<tr>
<td>(iii)</td>
<td>Paid by suppliers selling other materials to B</td>
<td>2,500</td>
</tr>
<tr>
<td>(iv)</td>
<td>Net tax paid by B</td>
<td>5,000</td>
</tr>
<tr>
<td>(v)</td>
<td>Paid by suppliers selling packing materials to C</td>
<td>250</td>
</tr>
<tr>
<td>(vii)</td>
<td>Net tax paid by C</td>
<td>2,250</td>
</tr>
<tr>
<td>(viii)</td>
<td>Net tax paid by D</td>
<td>2,500</td>
</tr>
<tr>
<td><strong>Total Recovery of Revenue</strong></td>
<td><strong>17,500</strong></td>
<td></td>
</tr>
</tbody>
</table>

**Illustration 1:** If inputs worth ₹ 1,00,000 are purchased and sales are worth ₹ 2,00,000 in a month, input tax rate and output tax rate are 4% and 12.5% respectively, then what will be the input tax credit/set-off and net VAT payable?
Solution:

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>Inputs tax paid within the month (₹ 1,00,000 x 4%)</td>
<td>4,000/-</td>
</tr>
<tr>
<td>(b)</td>
<td>Input tax credit of input tax paid</td>
<td>4,000/-</td>
</tr>
<tr>
<td>(c)</td>
<td>Output tax payable (₹ 2,00,000 x 12.5%)</td>
<td>25,000/-</td>
</tr>
<tr>
<td>(d)</td>
<td>Net VAT payable [(c) – (b)]</td>
<td>21,000/-</td>
</tr>
</tbody>
</table>

Illustration 2: Compute the VAT payable and VAT credit to be carried forward, if any, from the following particulars:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inputs purchased within a month</td>
<td>10,00,000</td>
</tr>
<tr>
<td>Outputs sold in the month</td>
<td>7,50,000</td>
</tr>
<tr>
<td>Input tax and output tax rate</td>
<td>12.5%</td>
</tr>
</tbody>
</table>

Solution:

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>Input tax paid @ 12.5% on ₹ 10,00,000</td>
<td>1,25,000</td>
</tr>
<tr>
<td>(b)</td>
<td>Tax @ 12.5% on sale of goods of ₹ 7,50,000/- during the month</td>
<td>93,750</td>
</tr>
<tr>
<td></td>
<td>Net VAT payable during the month (b) – (a)</td>
<td>NIL</td>
</tr>
<tr>
<td></td>
<td>Tax credit to be carried to the next month (a) – (b)</td>
<td>31,250</td>
</tr>
</tbody>
</table>

Illustration 3: Compute the net VAT payable and VAT credit to be carried forward, if any, from the following particulars:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax paid on purchases made in the State within a month</td>
<td>10,000</td>
</tr>
<tr>
<td>Tax charged for sales in the State within a month</td>
<td>4,500</td>
</tr>
<tr>
<td>CST charged for inter-state sales within a month</td>
<td>15,000</td>
</tr>
</tbody>
</table>

Solution:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net VAT payable (₹ 4,500 – ₹ 10,000)</td>
<td>NIL</td>
</tr>
<tr>
<td>Excess credit (₹ 10,000 - ₹ 4,500)</td>
<td>5,500</td>
</tr>
<tr>
<td>CST to be paid to Government (₹ 15,000 – ₹ 5,500)</td>
<td>9,500</td>
</tr>
<tr>
<td>VAT credit to be carried forward</td>
<td>NIL</td>
</tr>
</tbody>
</table>

Illustration 4: From the following particulars, compute the Net VAT liability of the month and VAT credit to be carried forward, if any.
Basic Concepts of Indirect Taxes – Value Added Tax

### Illustration 5:

R. Ltd. of Mumbai made a total purchases of input and capital goods of ₹60,00,000 during the month of February, 2015. The following further information is available:

1. Goods worth ₹15,00,000 were purchased from Assam on which CST @ 2% was paid.
2. The purchases made in February, 2015 include goods purchased from unregistered dealers amounting to ₹18,50,000.
3. It purchased capital goods (not eligible for input tax credit) worth ₹6,50,000 and those eligible for input tax credit for ₹9,00,000.
4. Sales made in Mumbai during the month of February, 2015 is ₹10,00,000 on which VAT at 12.5% is payable.

All purchases given are exclusive of tax. VAT @ 4% is paid on local purchases. Calculate the:

(a) amount of purchases eligible for input tax credit.
(b) amount of input tax credit available for the month of February, 2015.
(c) Net VAT payable for the month of February, 2015.

Input tax credit on eligible capital goods is available in 36 equal monthly installments.

#### Solution:

**Computation of purchases eligible for input tax credit, input tax credit available for February, 2015 and net VAT payable for the month:**

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Goods purchased from Assam on which CST @ 2% was paid</td>
<td>-</td>
</tr>
</tbody>
</table>
1.144 Indirect Taxes

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Purchases made from outside the State on which CST is payable are not eligible for input tax credit)</td>
<td></td>
</tr>
<tr>
<td>(ii) Purchases from unregistered dealers</td>
<td>-</td>
</tr>
<tr>
<td>(Purchases from unregistered dealers are not eligible for input tax credit)</td>
<td></td>
</tr>
<tr>
<td>(iii) Capital goods eligible for input tax credit</td>
<td>9,00,000</td>
</tr>
<tr>
<td>(iv) Balance purchases liable to VAT and thus, are eligible for input tax credit</td>
<td>11,00,000</td>
</tr>
<tr>
<td>( \text{₹ 60,00,000} - (\text{₹ 15,00,000} + \text{₹ 18,50,000} + \text{₹ 6,50,000} + \text{₹ 9,00,000}) )</td>
<td></td>
</tr>
</tbody>
</table>

**Purchases eligible for input tax credit**

- 20,00,000

VAT paid on purchases eligible for input tax credit

\( \text{(₹ 11,00,000 x 4%)} \)

VAT paid on capital goods eligible for input tax credit (input tax credit available in 36 equal monthly installments)

\[ \text{₹ 9,00,000 x 4%} \div 36 \]

Input tax credit available for February, 2015

45,000

Output VAT payable

1,25,000

\( \text{(₹ 10,00,000 x 12.5%)} \)

Less: Input tax credit available

45,000

Net VAT payable

80,000

5.8 Composition scheme for small dealers

(1) **Threshold for registration:** A dealer is a person who purchases, sells, supplies or distributes the goods in the course of his business for valuable consideration. The White Paper provides that registration for VAT is not compulsory for dealers having gross turnover up to ₹ 5 lakh. However, subsequently States have been allowed to increase such threshold limit to ₹ 10 lakh. Most of the States have kept the threshold limit for registration at ₹ 5 lakh. In case of Karnataka, the limit is ₹ 2 lakh.

(2) **Composition Scheme:** VAT system requires elaborate record keeping and detailed accounting, which increases the compliance cost of the dealers. Small dealers generally do not have the expertise and the knowledge to comply with requirements relating to records and accounts.
The White Paper, therefore, has provided a simple optional composition scheme for small registered dealers where tax is paid at a small percentage of the gross turnover. The scheme entails a simpler method of accounting for VAT. Input tax credit is not allowed under the scheme and the dealer opting for the scheme is not authorized to issue Vatable invoices.

**Composition rate:** The Empowered Committee has permitted the States to reduce the rate of composition tax to as low as 0.25%. The composition tax at the rate decided by the State Governments can be levied on the taxable turnover. The State Governments may also provide for different types of composition schemes to be notified for different classes of retailers.

(3) **Eligible dealers:** A dealer is eligible to opt for the Composition Scheme (scheme) if-

- he is a registered dealer;
- he is liable to pay tax under the respective State VAT Acts;
- his turnover does not exceed ₹ 50 lakhs in the last financial year; and
- all his purchases and sales are within the State.

(4) **Non-eligible dealers:** The following dealers are not eligible for the scheme:

- dealer making inter-state purchases;
- dealer making inter-state sales;
- dealer importing the goods for sale in India;
- dealer stock transferring goods outside the State;
- dealer exporting the goods;
- dealer desirous of issuing VAT-able invoice.

(5) **Exercising of option:** The dealer should not have any stock of goods which are brought from outside the State on the day he exercises his option to pay tax by way of composition. He should not use any goods brought from outside the State after such date. He should also not claim input tax credit on the inventory available on the date on which he opts for composition scheme.

(6) **Advantages and disadvantages of the scheme:** The advantages and disadvantages of the Scheme are tabulated in figure 13 given in the next page.

The scheme is basically useful for the dealers –

- (i) who directly sell to final consumers, who cannot avail any input tax credit; or
- (ii) who cannot maintain elaborate records required for availing input tax credit.
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5.9 VAT and Sales Tax Incentives

During the sales tax regime, State Governments used to offer sales tax incentives to new industries set up in the State with the ultimate objective of the development of the State. By and large the incentives were given in three modes as described below:-

### ADVANTAGES

- **Minimum records**: If a dealer avails this scheme, he need not maintain any statutory records as prescribed under the respective State VAT Acts. Only the records for purchase, sales, inventory have to be maintained.
- **Simple tax calculation**: Generally, a small tax is payable (normally 4% or lower).
- **Simple return**: A simple return form covers longer return period under such schemes.

### DISADVANTAGES

- **Non availability of input tax credit**: A dealer opting for the scheme cannot avail input tax credit on purchases made by him. Thus, it adds to the cost of the goods as the tax cannot be passed on.
- **VAT chain gets broken**: Since, a buyer purchasing from the composition dealer does not get any tax credit, the VAT chain gets broken, and the benefit of tax paid earlier is not passed on to the subsequent buyers. This ultimately leads to cascading of taxes.

### Exemption from tax

- Neither tax charged nor tax collected by the eligible industry.
- Input tax also not payable on purchases of raw materials.
- Exemption ceases either with the expiry of exemption period or the exemption amount, whichever occurs first.

### Deferment of tax liability

- Tax collected from the buyers but the payment thereof to the Government deferred.
- After the expiry of the prescribed period, the liability to be paid in specified installments.

### Remission of tax

- Tax collected from the buyers but the payment thereof remitted.
- Input tax paid on purchases by the unit to be refunded.

However, any exemption from tax is against the principles of VAT as it breaks the VAT chain. VAT system works on the basis of tax credit passed at each stage of production and
distribution through issuance of tax invoices. Therefore, the dealers effecting exempted sales break the VAT chain as they are not allowed to avail input tax credit and issue tax invoices to pass on the credit.

State Governments, therefore, stopped giving incentives to new industries after January, 2000. Howbeit, incentives already given to industries set up prior to January, 2000 were continued under the VAT regime by converting them to deferral schemes so that such industries could pass on the benefit of VAT to their buyers.

5.10 VAT and Works Contract

(1) Works contract liable to VAT: As learned in previous Unit, works contract is a deemed sale, which involves transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. Sub-clause (b) of clause (29A) of the Article 366 of the Constitution inter alia provides that the term "tax on sale or purchase of goods" include “a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract.” Therefore, works contract transactions, when executed within the State, are subject to VAT.

The definition of works contract provided under various State VAT laws are largely based on the definition of works contract as provided under Central Sales Tax Act [Refer Unit-4 for the definition of works contract under CST Act].

Example: Construction of a new building, turnkey projects including engineering, procurement and construction (EPC) or commissioning projects etc. are works contracts.

(2) Taxable turnover for works contract: Works contract is a composite contract of goods and services. While VAT is leviable on goods involved in the execution of works contract, service tax is levied on value of services.

(i) Taxable turnover where labour and other service charges are quantifiable

Taxable turnover to be contract price less labour and other service charges: Turnover for imposition of VAT in relation to the transfer of property in goods (whether as goods or in some other form) involved in execution of a works contract, shall mean sale price of goods in which there is transfer of property. The amount representing labour and other service charges incurred for such execution has to be excluded from the contract price to arrive at the taxable turnover for imposition of VAT [Refer Gannon Dunkerly decision – discussed in the previous Unit].

(ii) Taxable turnover where labour and other service charges are not quantifiable

(a) Taxable turnover to be cost of goods plus cost of transfer/conversion and profit margin: Where such labour and other service charges are not quantifiable, the sale price shall be the cost of acquisition of the goods and the margin of profit on them prevalent in the trade plus the cost of transferring the property in the goods and all other expenses in relation thereto till the property in them, whether as such or in any other form, passes to the contractee and where the property passes in a different form, the sale price shall include the cost of conversion.
(b) **Standard rate of deduction:** Alternatively, dealers can also make use of the standard rate of deduction provided in the State VAT laws for deducting labour and other like charges in the contract to arrive at the taxable turnover for imposition of VAT.

(3) **Tax rates:**

(a) **Schedule rate:** As a basic feature, tax is chargeable on the transfer of property in the goods involved in the execution of a works contract at the rates prescribed for the concerned goods in the schedules of the concerned State VAT legislation. Where the value of each item of material transferred in the course of execution of a works contract is identifiable, tax is charged on the value of individual items of materials as provided under the schedules to the concerned State VAT legislation. The contractor is entitled to avail input tax credit on inputs.

(b) **Revenue neutral rate:** If the values of individual goods are not identifiable, contractor can pay tax at Revenue Neutral Rate (RNR - generally 12.5%/13.5%) after deducting the value attributable towards labour and other like charges.

**Illustration 6:** Determine the taxable turnover, input tax credit and net VAT payable by a works contractor from the details given below on the assumption that the contractor maintains sufficient records to quantify the labour charges. Assume output VAT at 12.5%.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ (in lakh)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Total contract price (excluding VAT)</td>
<td>100</td>
</tr>
<tr>
<td>(ii) Labour charges paid for execution of the contract</td>
<td>35</td>
</tr>
<tr>
<td>(iii) Cost of consumables used not involving transfer of property in goods</td>
<td>5</td>
</tr>
<tr>
<td>(iv) Material purchased and used for the contract taxable at 12.5% VAT (VAT included)</td>
<td>45</td>
</tr>
</tbody>
</table>

The contractor also purchased a plant for use in the contract for ₹ 10.4 lakh (inclusive of VAT). In the VAT invoice relating to the same, VAT was charged at 4% separately. Assume 100% input tax credit is available on capital goods immediately.

Make suitable assumption wherever required and show the working notes.

**Solution:** Under works contract, where labour and service charges are quantifiable, the turnover for imposition of VAT is the contract price less the labour and other charges incurred for such execution.

**Computation of the taxable turnover, input tax credit and net VAT payable by the works contractor:**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total contract price</td>
<td>1,00,00,000</td>
<td></td>
</tr>
<tr>
<td>Less : Deductions admissible</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Labour charges paid for executing the contract</td>
<td>35,00,000</td>
<td></td>
</tr>
<tr>
<td>2. Cost of consumables in which no property is transferred</td>
<td>5,00,000</td>
<td></td>
</tr>
</tbody>
</table>
Basic Concepts of Indirect Taxes – Value Added Tax  1.149

<table>
<thead>
<tr>
<th>Total deductions</th>
<th>40,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable turnover</td>
<td>60,00,000</td>
</tr>
<tr>
<td>Output VAT payable @ 12.5% (on ₹ 60,00,000) [A]</td>
<td>7,50,000</td>
</tr>
<tr>
<td>Less : Admissible input tax credit</td>
<td></td>
</tr>
<tr>
<td>1. On material (₹ 45,00,000 x 12.5/112.5)</td>
<td>5,00,000</td>
</tr>
<tr>
<td>2. On plant (₹ 10,40,000 x 4/104)</td>
<td>40,000</td>
</tr>
<tr>
<td>Input tax credit [B]</td>
<td>5,40,000</td>
</tr>
<tr>
<td>Net VAT payable [A] – [B]</td>
<td>2,10,000</td>
</tr>
</tbody>
</table>

(4) Composition Scheme: The salient features of the Composition Scheme provided under various State VAT Acts are:

- VAT legislations provide for an optional Composition Scheme to collect tax on works contracts in a simple manner so as to minimize the inconvenience caused to the assessees.
- Tax is paid at a composite rate on the gross contract value. The tax rate is generally lower in such scheme.
- Input tax credit is not allowed under the scheme. However, in some States (e.g. Maharashtra) partial input tax credit is granted.

(5) Input tax credit on capital goods: Several kinds of works contracts do not involve any manufacturing or processing of goods e.g. contracts for construction of roads, bridges, etc., and yet capital goods of substantial value are used in the execution of such contracts. Majority of the VAT legislations provide for availing of input tax credit on capital goods only where such goods are used in manufacturing or processing of goods.

5.11 VAT and Lease Transactions

(1) What is a lease? A lease is a special type of transaction, under which a party owning the asset (called the 'lessor') provides that asset for use over a certain period of time to another party (called the 'lessee') for consideration (called 'rentals'). The legal ownership of the asset remains with the lessor, but the lessee retains the possession and uses the asset over the period of the lease. The characteristics of a lease can be summarized as under:
Lease transactions are liable to VAT: As learned in previous Unit, lease is a deemed sale. Sub-clause (d) of clause (29A) of Article 366 of the Constitution *inter alia* provides that “tax on sale or purchase” includes “a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration.” In common parlance, these transactions are known as lease of goods and the tax on these sales is referred to as “lease tax”.

Therefore, lease transactions when effected intra-state are liable to VAT. Inter-state leasing is subject to CST.

However, if an asset is given on rent for use but the complete possession and control of the asset is not handed over, the transaction is not a deemed sale as it is not a transfer of right to use. In such a case, it becomes a service liable to service tax.

**Example:** If a machinery is given on rent but the operator thereof is provided by the person giving the machinery for use, the transaction becomes a service as complete possession and control of the asset is not handed over. However, if the machinery is given on rent with full control and possession (the person taking the machine on hire is free to use it as per his requirements) then the transaction becomes a deemed sale.

**Sub-lease:** Transfer of the right to use goods does not require that the goods should be owned by the person effecting such transfer. Accordingly, sub-lease of an asset too can be taxed, unless the State Value Added Tax law has provided for the levy of tax only at one stage.

Taxable event: Taxable event is the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration. Thus, a transfer which is gratuitous is not taxable. Likewise, transfer of the right to use *immovable property* - not being goods - like renting a house or factory is not taxable.

**Taxable turnover:** Normally, the sale price means the amount of valuable consideration paid or payable for any sale made during the given period. It also includes some other charges before delivery thereof. However, certain States have provided for the deduction of interest or finance charges for the purpose of determination of sale price/taxable turnover.

**Input tax credit:**

(i) **Input tax credit allowed on purchase of the asset which is to be leased:** The lessor pays VAT (input tax) at the time of procurement of goods. However, liability to pay VAT (output tax) on lease rentals is spread over the tenure of the lease. Therefore, some States provide for utilization of input tax credit for paying output tax only over the entire period of lease. This results in accumulation of input tax credit in the hands of the lessor for a long period of time. However, States like Maharashtra have provided for immediate utilization of such input tax credit against payment of any tax.

(ii) **Input tax credit as capital goods:** The assets given on lease are generally capitalized by the lessor in his books and are treated as capital assets. Thus, provision relating to input tax credit on capital goods apply in this case also, e.g. if VAT law provides to give
input tax credit on capital goods in 36 months, then irrespective of period of lease, input tax credit would be available only in 36 months.

(6) Maintenance of leased asset: Maintenance of the leased asset involving supply of materials for maintenance/repair, which are in the nature of consumables, by the lessor does not amount to works contract, as there is no transfer of property in such materials to the lessee. Thus, there would be no VAT on the value of the consumables used during maintenance/repair of the asset. In such a case, the contract becomes a service contract liable to service tax.

However, if parts are also supplied during the maintenance, then such contract becomes a works contract liable to VAT as there is a transfer of property in goods involved in the execution of the contract. In such a case, the materials required for such maintenance/repair would be input for sale and input tax credit will be available.

(7) Sale of leased asset after lease period: Sale of a leased asset after the lease period is over is taxable in the same manner in which normal sale of such asset would have been taxed. Normally, such sale is effected to the same lessee and hence such sale would be a local one exigible to tax under the VAT laws of the State in which the asset is located.

5.12 VAT and Hire-Purchase Transactions

(1) Hire-purchase: Hire-purchase is a type of installment credit under which the hire purchaser, called the hirer, agrees to take the goods on hire at a stated rental, which is inclusive of the repayment of principal as well as interest, with an option to purchase. Under this transaction, the hirer acquires the goods immediately on signing the hire-purchase agreement but the ownership or title of the same is transferred only when the last installment is paid.

In the case of hire-purchase, property passes in the goods when the hirer exercises his option to purchase the goods subject to the fulfillment of the terms of the agreement and then the transaction fructifies into a concluded (normal) sale.

<table>
<thead>
<tr>
<th>Hire-purchase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership of the goods remains with the seller until the last installment is paid. Buyer gets the ownership only after paying the last installment.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Installment payment system</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buyer gets the ownership of the goods with the payment of the first installment.</td>
</tr>
</tbody>
</table>

[Fig. 16]
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It may be noted that in hire-purchase transactions, the word ‘purchase’ is of primary significance while ‘hire’ is an adjunct. In a contract of hire-purchase the contract is for ‘purchase’ with the attributes of hire and not ‘hire’ with the attributes of a purchase.

(2) Hire-purchase liable to VAT: As learned in previous Unit, hire purchase is a deemed sale. Sub-clause (c) of clause (29A) of Article 366 of the Constitution inter alia provides that “tax on sale or purchase” includes “a tax on the delivery of goods on hire-purchase or any system of payment by installments.”

By virtue of this sub-clause, State legislations have been able to deem that a sale takes place on the date of delivery of the goods on hire purchase notwithstanding the fact that the option to purchase is exercised only at the end when the title of the goods as per the terms stands transferred from the dealer to the hirer.

Therefore, intra-state hire-purchase transactions are liable to VAT. Inter-state hire-purchase transactions are subject to CST.

Under VAT laws of different States, hire-purchase and installment sales are at par with normal sales and hence the provisions of the State VAT laws as applicable to normal sales are equally applicable to hire-purchase and installment sales.

Pure financial transactions (Hire-purchase finance) not liable to VAT: Transactions which are purely of a financial nature between the financier and the hirer are not covered by sub-clause (c) of clause (29A) of Article 366. Where it is explicit in the hire-purchase contract that the reservation of title by the financier is merely a matter of security, such a transaction is a pure financial transaction. There is no real sale of the asset by the financier to the hirer and thus, such pure financial transactions are not liable to VAT.

(3) Taxable event: The definition of sale under value added tax laws of various States provides that the taxable event will be the actual or physical delivery of goods on hire purchase or under any system of payment by installments. It is implicit that such transaction should be for monetary consideration.

It is important to note that in case of hire-purchase transactions, the delivery of the goods has been made the taxable event and not the completed sale on payment of the last installment.

(4) Input tax credit: The hire purchase transaction is at par with normal sale transaction. Therefore normal provisions relating to input tax credit apply in this case also. However, some States have provided for prorata credit.

Some special aspects:

- Liability to tax when sale concludes: A debatable question which arises is whether in case of hire-purchase, VAT will have to be paid again at the time when transaction fructifies into a concluded sale, inspite of tax having been deposited on installment (payable as and when due, whether or not recovered). Answer to this problem depends mostly upon the provisions of the VAT laws of the States in which the goods are located when the transaction fructifies into a concluded sale.

One view is that when the transaction fructifies into a concluded sale, tax will not be payable as tax has already been paid on installments. However the other view is that,
earlier tax was a tax on delivery of the goods on hire-purchase or installment. Therefore, at that time only the consideration received for hire-purchase or installment was taxed and the consideration receivable at the time of concluded sale does not get taxed. Hence, tax is payable again on the fructified sale on the depreciated value of the asset or its market value. The second view appears to be logical. However, if no consideration is payable on fructified sale, then tax is not attracted.

- **Finance charges/interest**: It is common knowledge that the installment fixed for payment in the case of a hire-purchase arrangement involves an element of interest or finance charges in addition to the price of the goods sold. While some of the State VAT legislations have provided for deduction of such interest or finance charges in arriving at the sale price to be treated as turnover in a hire purchase transaction, some States have not done so.

- **Goods returned**: VAT is payable on the date of delivery of the goods. If for any reason the goods are returned, then refund of tax will have to be claimed as per the provisions of respective State VAT laws. In substance, this is a sales return. Many States have provided a time limit for granting the claim of goods returned. Therefore, if the goods are not returned during that specified period, no benefit will be available.

- **Unpaid installments/ forfeited installments**: If for any reason, the transaction of hire purchase fails, then the vendor takes possession of the goods. Normally, in such cases the installment received for the intervening period are forfeited.

### 5.13 VAT and sale of food articles

As per clause (f) of Article 366 (29A) of the Constitution, “tax on sale or purchase” includes “a tax on supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating) where such supply or service is for cash, deferred payment or other valuable consideration.”

Thus, sale of food in hotel is a deemed sale liable to VAT. Service tax law considers that such a transaction involves element of service also and thus, the service portion involved in such a sale is declared to be a service liable to service tax.

### 5.14 Deficiencies in State-Level VAT

The State-Level VAT in India is not a perfect system of VAT. It has the followings flaws:

(i) **Non-uniformity in VAT rates across the country**: One of the primary reasons for implementation of VAT had been to do away with the multiple rates of sales tax prevalent in different States leading to unhealthy competition between the States and distorted economic development of the country. However, under VAT regime also States have deviated from the agreed rate structure prescribed by the White Paper to suit their individual requirements. Thus, in the present scenario also, VAT rates are not uniform all over India.
(ii) **Non-uniformity in provisions of VAT laws across the country:** The provisions of VAT Acts and Rules as also the varied procedures are not uniform across the country.

(iii) **CST non-Vatable:** Non-availability of credit of central sales tax leads to cascading of taxes.

(iv) **Double taxation:** There is no clear distinction between goods and services which leads to double taxation as both Union and State Governments tax the same transaction in different ways i.e., both service and VAT tax are levied on the same transaction. Union Government treats the transaction as service and levies service tax while State Governments treat the transaction as sales and levy State VAT. For instance, both VAT and service tax are levied in case of software.

(v) **Hurdles in movement of inter-state goods:** Since, the State-Level VAT is not a National VAT, goods moving from one State to another have to cross through check posts at State borders which causes delays, corruption and harassment.

### 5.15 VAT procedures

(1) **Registration:** Registration is the process of obtaining certificate of registration (RC) from the authorities. A dealer registered under a VAT Act is called a registered dealer. Any dealer, who intends to carry on the business of purchase and sale of goods in the State and is liable to pay tax, cannot carry on the business unless he is registered and holds a valid registration certificate under the Act [Refer Heading 5.8 of this Unit for discussion on threshold for registration].

**Tax Payer’s Identification Number (TIN):** TIN (Tax Payer’s Identification Number) is the registration number of the dealer consisting of 11 digit numerals throughout the country. First two characters represent the State code as used by the Union Ministry of Home Affairs. The set of the next nine characters are however, different in different States.

(2) **Invoice:** Invoice is a document listing goods sold with price, tax charged and other details as may be prescribed and issued by a dealer authorized under the Act. The White Paper provides that:

(i) Every registered dealer whose turnover of sales exceeds the specified amount shall issue to the purchaser a serially numbered tax invoice, cash memo or bill with the prescribed particulars.

(ii) The tax invoice shall be dated and signed by the dealer or his regular employee, showing the required particulars.

(iii) The dealer shall keep a counterfoil or duplicate of such tax invoice duly signed and dated.

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2 Though the basic concepts relating to VAT apply in respect of all the States, the procedural law differs on many counts from State to State. Therefore, a bird’s eye view of the significant VAT procedures has been given in this Unit with the objective of familiarizing the students with the basic aspects of significant procedures under VAT Laws.
Importance of VAT invoice (tax invoice): Invoices are crucial documents for administering VAT. In the absence of invoices, VAT paid by the dealer on the inputs/capital goods cannot be claimed as set off. Invoices should be preserved with full care. In case any original invoice is lost or misplaced, a duplicate authenticated copy must be obtained from the issuing dealer.

Contents of VAT invoice: Generally, the various legislations provide that the tax invoice should have the following contents:

(i) the words ‘tax invoice’ in a prominent place;
(ii) name and address of the selling dealer;
(iii) registration number of the selling dealer;
(iv) name and address of the purchasing dealer;
(v) registration number of the purchasing dealer (may not be required under all VAT legislations);
(vi) pre-printed or self-generated serial number;
(vii) date of issue;
(viii) description, quantity and value of goods sold;
(ix) rate and amount of tax charged in respect of taxable goods;
(x) signature of the selling dealer or his regular employee duly authorized by him for such purpose.

(3) Returns: A registered dealer has to required to file monthly/quarterly/annual returns as per the provisions of the State Acts/Rules along with the tax payment challans. The returns should disclose the details like output tax liability, value of input tax credit, payment of VAT.

The dealer also has the option of filing the revised return within the stipulated time period under the VAT provisions. The composition dealers are also required to file the return on periodical basis as stipulated under the respective State VAT provisions.

(4) Audit by Chartered Accountants: Apart from the Departmental Audit, many States have also incorporated the concept of audit of accounts by Chartered Accountants. However, auditing for all types of dealers may not be necessary. For example, in Maharashtra and Rajasthan, the dealer whose turnover exceeds ₹ 40 lakhs in any year is required to get his accounts audited in respect of such year.