

INTRODUCTION TO K- VAT

By, Madhukar Hiregange FCA, DISA(ICAI)

History and Background

The concept of VAT (Value Added Taxation) was first implemented in France in 1954. More than 130 nations have embraced VAT beneficially. In India itself the adopting of VAT by Haryana has given it an edge and at the same time its revenue has also gone up. VAT is universally accepted and its principals ensure smooth tax collections as at each stage tax on the value addition only is to be paid.

What is VAT?

Value Added Taxation as the name suggests is a method of taxation wherein the taxes paid in the earlier stages are allowed to be set off against the taxes to be paid. That is to say that the taxes are only paid on the value addition at each stage. In its pure form the value addition can be in the form of profits or service charges or a portion of the overheads. This ensures that the cascading effect of duty is not suffered by goods at each point of sale or conversion. An illustration of the cascading effect is provided hereunder for clarity:

Suppose a dealer purchases raw materials worth Rs. 100 with a tax rate of 13.5% and manufactures spare parts, and makes a value addition of Rs. 50, in the absence of set off, he would sell the product to his customer at Rs. 163.50. If the tax rate on sale is 13.5%, the total value would be Rs. 185.50 with the tax payable being Rs. 22.00. If the set off is available, the price would be Rs. 150 with the tax on input being available for set off. The total price would be Rs. 170.25 with the tax payable being Rs. 20.25. This can be used for setting off by the customer where he himself happens to be a dealer. For the seller, the net outflow would be Rs. 6.75 (20.25-input set off of Rs. 13.5 on purchases). This in effect is the tax on his value addition alone.

A modified version of this set off scheme has been in force in India in the form of Cenvat under Central Excise Law. Under KVAT Act, the set off available is of tax paid under this Act and not under any other Act. In other words, where CST is paid on interstate purchase, the same will not be available for set off though KVAT paid on inputs used in interstate sales can be set off against CST payable on such interstate sales.

Understanding Karnataka VAT at a Glance

K-VAT would cover the organised and unorganized sectors. The dealers who are small also may require to get under the VAT scheme to survive as the buyer would not be interested in dealing with them otherwise. The confirmation of coverage under K-VAT and the basic principles of VAT can be understood stage wise. Once the liability is confirmed and the concepts are understood then the procedural compliance would be ensure that the law is complied with as well as avoid demands and disputes. The brief aspects of principles of VAT, availability of credit are provided hereunder:-

Coverage: The dealer who carries on the business of selling or purchasing, supplying, distributing goods directly or otherwise, whether for cash or for deferred payment, or for commission, remuneration or other valuable consideration. within the state would be covered.

Even a casual trader as well as the government undertakings would be covered.. Clubs/associations/societies would be dealers if they distribute goods to members (whether or not in course of business). An agriculturist (excluding companies selling pepper, cardamom, rubber, timber, wood, raw cashew or coffee cultivated personally by them) who sells products cultivated by him personally or a person who is exclusively engaged in poultry farming would not be dealers.

Levy: Section 3 of K-VAT Act sets out that the levy is attracted on the dealer on his sale of goods within the state, on the use of goods in the execution of a works contract and on amounts received for the right to use.(Hire charges).

K-VAT is also payable on the purchase of goods from the unregistered dealer at the rates as specified.

K-VAT is only attracted where the transfer of property takes place within Karnataka. That is say where the ownership changes from one to another for a consideration. There are some deemed sales in case of incorporation in works contracts and in case of hiring out of equipments, which would also fall within the mischief of K-VAT.

Place of Sale: In this scheme of things the place (situs) of the sale is important. Where the transfer of right to use goods is involved, sale is said to be within the state if the goods are for use within the state. Sale is also deemed to be within the state in case of

contract of sale or purchase where in case of specific or ascertained goods, the goods are within the state at the time when such contract is made. In case of unascertained goods, sale will be within the state if the goods are within the state at the time of their appropriation to the contract of sale or purchase.

Time of sale: The sale of goods shall be deemed to take place at the time of transfer of title or possession of goods in the course of execution of works contract. Where an invoice is raised within 14 days from the date of sale, the sale shall be deemed to have taken place at the time the invoice is raised.

Persons Liable: The seller of the taxable goods or the works contractor is liable to be registered under K-VAT is liable to pay the K-VAT.

A dealer could be liable to register under the KVAT Act when -

- ✓ His taxable turnover is likely to exceed rupees five lakhs during any year
- ✓ His taxable turnover exceeds forty thousand rupees in any one month
- ✓ A business or part of a business is transferred to him by another dealer liable to register but who has not registered
- ✓ He obtains or brings goods from outside the state whether as a result of purchase or otherwise
- ✓ He exports goods outside the country
- ✓ He effects a sale in the course of interstate trade or commerce or dispatches goods to a place outside the state
- ✓ He is a casual trader or a non-resident dealer or his agent
- ✓ He is involved in the execution of works contract

Collection of Tax: Section 9 sets out that the collection of K-VAT is the responsibility of the registered dealer who is to collect the same. He is to account for the same and remit the same to the state.

In case of works contracts in certain cases where the payments are to be made by Government or governmental agencies they have been fastened with the duty to deduct the tax payable by the dealer while making the payment to the dealers.

Tax payable: Section 10 sets out the amount payable is the net tax, which is arrived at by deducting the input tax credit from the output tax in the tax period, which has been fixed as 1 month. (Net Tax payable = Output Tax – Input Tax)

Output Tax- This is the tax payable by the dealer on the levy being attracted for the goods sold. In case of an agent who is selling the goods the output tax is payable by him whether he represents a non resident dealer or a resident dealer. This is on the logic that the K-VAT should be charged at the point of sale. The principal who would include the value of the agents sales would be eligible for deduction on receipt of declaration from the agent.

Input Tax – This is the tax paid by the dealer on his purchases or the tax paid by him on unregistered dealer purchases. The tax paid on goods should be in the course of business and therefore the tax paid on personal purchases would not be admissible. The credit is also available for capital goods, which are used for the business. The present scheme does not provide credit on all the inputs but has imposed certain bars/restrictions on certain type of transactions.

“**Input**” means any goods including capital goods purchased by a dealer in the course of his business for re-sale or for use in the manufacture or processing or packing or storing of other goods or any other use in business.

“**Capital goods**” means plant, including cold storage and similar plant, machinery, goods vehicles, equipments, moulds, tools and jigs and used in the course of business other than for sale.

The restrictions as to the deduction of input tax in the calculation of net tax payable are basically contained in section 11 and 12 of the VAT Act besides Schedule V to the KVAT Act. Section 12 deals with the capital goods whereas Section 11 concentrates on inputs.

Input tax is not deductible in the following cases –

- ✓ Input tax paid on purchases attributable to the sale of goods exempted u/s 5 unless such goods are sold in the course of export out of the territory of India.
- ✓ Input tax paid on goods specified in the Fifth Schedule and subject to such conditions as may be specified, purchased and put to use for purposes other than for resale or manufacture or any other process of other goods for sale.
- ✓ Tax paid on purchase of goods as may be notified by the Govt. or the Commissioner subject to specified conditions.

- ✓ Input tax paid on purchases attributable to naphtha, liquefied petroleum gas, furnace oil, superior kerosene oil, kerosene and any other petroleum product, when used as a fuel in motor vehicles.
- ✓ Input tax paid on purchase of fuel from unregistered dealers.
- ✓ Input tax on goods purchased by a dealer who is required to be registered under the Act, but has failed to register.
- ✓ Input tax paid by an agent purchasing or selling goods on behalf of any other person other than a non-resident principal.

Where the input tax is paid in terms of purchases (other than fuel) from an unregistered dealer, no deduction shall be allowed until the output tax is payable on such goods or other goods in which such goods are put to use (except when the said goods are exported out of the territory of India).

Tax paid on purchase of LDO would be available as a set off as the reference in section 11(6) has been deleted with retrospective effect from 01.04.2005. This means set off on LDO used in motor vehicles should be available.

The dealer seeking set off shall also ensure that the inputs are not subject to restriction under Schedule V to the Act as far as input tax set off is concerned.

A dealer who is claiming deduction towards amount paid/payable to Subcontractor cannot claim input tax credit. This amendment has been given retrospective effect.

For instance:

Mr. A is a main contractor for 15 construction projects in Karnataka. He subcontracts one of the project to Mr. B. Mr. A claims full deduction of the amount paid/payable to Mr. B. Mr. A is eligible for claiming input tax credit on the purchases made for other 14 projects.

Special Rebating Scheme:

As per Section 14 of the Act, the deduction of input tax shall be allowed to the extent of the input tax charged at a rate higher than four percent or any other lower rate notified by the government in respect of the following purchases—At present it is 3%.

- ✓ Purchases of goods that are dispatched outside the state (other than through sale), or are used as inputs in the manufacture, processing or packing of other taxable goods, which are dispatched to a place outside the state other than as a direct result of sale or purchase in the course of inter-state trade.

- ✓ Purchases of naphtha, liquefied petroleum gas, furnace oil, superior kerosene oil, kerosene and any other petroleum product used as fuel in the production of any goods for sale in the course of export out of the territory of India or taxable goods or captive power.

With regard to the capital goods input tax, the following may be noted as per Section 12–

- ✓ The input tax deduction is available in respect of the purchase of capital goods for use in the business of sale of any goods in the course of export out of the territory of India in case of registered dealer.
- ✓ Input tax deduction is also available in respect of purchase of capital goods wholly or partly for use in the business of taxable goods. In such cases the set off will be in the manner prescribed.
- ✓ Deduction is available only after commencement of production, or sale of taxable goods or sale of any goods in the course of export out of the territory of India by the registered dealer.
- ✓ The deduction shall be available in one lump sum since the system of apportioning was done away with in 2006 by way of an amendment in section 12.

The taxable turnover of the dealer should not be less than the limit fixed u/s 22(2) in the year of purchase in order to avoid a situation where set off is not available on capital goods. (Limit is Rs. 5 lakhs)

Classification & Rates of Tax: Once the taxable event occurs then the examination of the rates applicable are to be made. The classification of the present goods are in the following categories:

| Schedule No. | Rate of K-VAT |
|---------------------------------|---------------|
| First | Nil |
| Second Schedule | 1% |
| Third Schedule | 5% |
| Forth Schedule | 20 % |
| Other Goods not specified above | 13.5 % |

In addition the specific exemption notifications may require to be perused where the state may grant exemption.

The classification of the goods by their description would be preferable and in case of any doubt then the revenue neutral rate (RNR) of 13.5 % should be adopted.

Composition of Tax: A special scheme has been provided for small dealers whose turnover does not exceed Rs 50 Lakhs; works contractors (without limit); restaurants/ hotels (without limit) , Outdoor caterers (without limit), dealer running sweet stall or an ice cream parlour, bakery; or mechanized crushing units producing granite or any other metals. In this scheme the person who opts for composition May opt to pay an amount at 5% on total turnover or total consideration for works contracts executed by him or as not exceeding Two lakhs rupees for each crushing machine pa(in respect of crushing units). Any dealer who opts for composition of tax cannot claim any input tax credit on purchases made by him.

Registration: The dealers who indulge in interstate trade or imports/ exports or whose taxable turnover in the year crosses Rs.5 Lakhs or a works contractor executing works contract in the state or a casual trader/ agent of non resident after the first sale are liable to be registered. The registration would be granted after taking security as maybe set out.

Sale on Tax Invoice/ Bill of Sale: The fulcrum of the K-VAT scheme is the invoice under which the sale takes place. The law seek to control the same by prescribing some disclosures and methodologies. . In case of sale of exempt goods or if the dealer pays tax under composition scheme, he is to issue a bill of sale. With effect from 01.04.2007, the amendments made even allow for affixing of digital signatures on the tax invoices.

The tax invoice raised by the dealer should consist of complete details regarding the sale such as, serial number of invoice, date of issue of invoice, time of issue of invoice, name, address and registration number of the selling dealer, name and address of the buyer with registration number, full description of the goods, quantity of goods, value of the goods, rate and amount of tax charged in respect of taxable goods, total value and the signature of the selling dealer or his agent.

As per law, a duplicate invoice can be raised when the buyer requests for the same in case of loss of the original. The duplicate copy is to specifically state the fact that it is a duplicate.

The Bill of sale shall contain the details such as, a consecutive serial number, date of sale, the name, address and the registration number of the selling dealer, description of the goods, the value of the goods.

Records and Accounts: Every registered dealer and every dealer liable to pay tax under this Act, shall keep and maintain a true and correct account of all his purchases, receipts, sales, other disposals, production, manufacture and stock showing the values of goods subject to each rate of tax under this Act including the input tax paid and output tax payable.

For certain class of dealers, the commissioner shall notify to install and use an electronic tax register, so that there is access to the department authorities to the information, affecting his tax liability. Further the dealer should issue tax invoices/bills of sale from the electronic tax device.

An electronic tax register is a secure fiscal electronic device meant to issue tax invoices or bills of sale and record the details of such sales, and includes a printer and a device to affix signature of the dealer or his agent.

Returns: The returns are to be filed in the assessment period, which is 1 month by the 20th of the subsequent month after payment of the tax as set out. The dealer under composition scheme who is required to file tax returns within 15 days after the end of the preceding month is required to pay the tax due on such returns within 15 days only. In case of error the revised returns maybe filed within a period of 6 months.

Self - Assessment: Assessment means an assessment made or deemed to have been made on a return filed by the dealer under this Act and includes re-assessment (which can be taken up where a return is deemed to incorrectly assessed or section 38 assessment is regarded to have understated tax liability)

- ✓ Best judgement assessment may be taken up where the return is not filed (monthly or final).
- ✓ Assessment can be withdrawn when return is filed after best judgement assessment (within one month of receipt of assessment) but penalties and interest would be payable.
- ✓ Period of limitation for assessment/re-assessment normally is five years from the end of the tax period unless facts necessitating re-assessment were discovered

- in which case, it would be 3 years from the knowledge of such fact (without curtailing initial period of five years)
- ✓ In case of fraud or unregistered dealers liable to be registered, the period will be ten years
 - ✓ Period relating to disposal of appeals shall not be reckoned to compute the period of limitation

Best Judgement Assessment / Protective Assessments: Best judgement assessment may be taken up where the return is not filed (monthly or final). In such cases, tax shall be paid within 10 days from the date of receipt of assessment.

Interest: The dealer who fails to pay the tax or delays in payment of tax would be liable to pay 1.25% per month tax on the amount unpaid. For part period the number of days maybe reckoned.

Penalty: There are a number of penalties,. However for evading the taxes, not keeping accounts, not getting audited, not meeting obligation to issue bill of sale or tax invoices etc they would be applicable.

Refunds: The amount if any refundable would carry interest @ 6% per annum if the same is not refunded within a period of 35 days of the order.

Production of Documents, Entry, Search and seizure: The officer duly authorised by the Commissioner may direct the dealer to produce the records/ documents for examination or enter and search the premises of any dealer if he has reason to believe that there is concealment. He may also seize such documents. The extract of records can be taken as well as marks can be placed on such records. The seized documents can be retained for 180 days at a time (with permission from higher authority beyond this period not exceeding 60 days at a time). Samples of goods can be taken.
.The production and seizure of electronic tax register during the search operation can be demanded.

The audit party authorized by C&AG of India is empowered to direct any registered dealer produce accounts, registers, electronic tax register and documents relating to the business activities.

Inspection of Goods Movement: The transporter should carry the tax invoice, bill of sale, delivery note or other prescribed documents evidencing the materials being transported. He is to report at the first check post in the state and provide copies of the documents. In case of entry into the state provide the same at the first check post on entry.

Appeals: Any aggrieved person objecting to any order passed may appeal against the same within 30 days of communication of the order. Against this order another appeal lies to the Appellate Tribunal. Against this there is an appeal to the High Court.

Audit: Every dealer whose total turnover in a year exceeds 60 Lakhs Rupees shall have his accounts audited by a CA or Cost Accountant or a tax practitioner. Every dealer whose turnover exceeds Rs 40 Lakhs for year ending 31st March 2010 shall get accounts audited. For the audit of the accounts for the year 2009-10 to be conducted in the year 2010-11 the total turnover of the year 2009-10 should exceed 40 lakhs.

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Power of Government: The power to make Rules has been retained to ensure that the purpose of tax administration is achieved.

The purpose of this article is to provide a flavour of K-VAT and this article does not purport to be an in depth analysis of K-VAT.