

CROSS BORDER CONSUMPTION TAXATION UNDER VAT REGIME – A NEW AREA OF SPECIALIZATION FOR PROFESSIONALS

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INTRODUCTION

Many organisations feel that they lack control over subsidiary tax compliance affairs. This situation becomes more complex in the light of focus on good tax governance and compliance. The approach of tax specialists fits well with groups seeking better tax governance and tax management across a number of territories or with multiple entities in one territory. This is particularly so where corporates are entering new countries or where accounting and finance resources are being moved into shared service centres. The specialists can provide quality technical support including: coordination of multi country compliance requirements; corporate tax return preparation; compliance support with other taxes (eg. State and local taxes); tax payment advice; tax compliance time limit monitoring; tax compliance outsourcing services; tax compliance process improvement; and integration with local country statutory accounting compliance services.

NEED OF SPECIALIST SERVICES

Need of tax-efficient international assignment structures and policies is a must. The ability of professional specialists to operate profitably in diverse geographic markets, and to shift operations flexibly between countries results as an essential to the success of the business. But operating globally generates a wide variety of practical, legal, HR and finance issues. Multinational firm has to comply with host countries' laws on tax, pensions, business practices and human resources. One country's entrepreneur may be another's antitrust violator.

With the increasing focus on governance and regulation, tax compliance has never been so important.

Cross-border transactions need to manage multi-territory compliance requirements and keep abreast of changes in local legislation in each country that affect these requirements, while often facing additional pressures such as a lack of resources and the need to control costs and reduction of taxes. Multinational businesses are increasingly affected by tax, legislative and regulatory developments throughout the world. Understanding the impact of these developments on business operations and transactions between countries is vital for a company's survival. Professional specialists can help in managing global tax compliance issues, risks and opportunities. Having a strong international network of tax practitioners, they provide a consistently high quality service, coordinated across as many territories as possible.

The network of professionals in international tax structuring can help in greater tax governance by addressing latest developments as well as all aspects of cross-border taxation. They are well equipped and can structure cross border businesses in a tax-efficient manner, besides local managing by constructing effective cross-border strategies and managing global structural tax rate. Being enriched in knowledge and abreast of new developments in the international arena that affect international business, the professional specialists can advise on various issues like:

- foreign companies tax planning;
- income tax treaties;
- tax efficient holding company locations;
- cross-border financing and treasury solutions;

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BACKGROUND

- tax efficient supply chain and shared services;
- tax harmonization and regional tax issues under VAT etc.

One of the main reasons of tax complexity arises due to a shift of emphasis to consider both forms of potential double taxation together.

CROSS-BORDER TAXATION

The term, “cross-border taxation” means taxation in more than one country. In the international scenario, analysis of corporate taxation is very complex. This tax complexity arises due to a number of reasons. The prominent three reasons are:

1. Ways of Cross-border Investment;
2. Issues of Double Taxation involved;
3. Involvement of Minimum two Countries.

1. Ways of Cross-border Investments

Various ways in which cross-border investments can be made are:

- (a) Investment by an individual in a domestic company which further invests in a foreign business i.e., permanent establishment;
- (b) Investment by an individual in a foreign company which further invests in a business in its own country;
- (c) Investment by an individual in a domestic company which invests in a foreign company, which further invests in a business unit in its own country.

The main taxation issue in the above alternatives is, whether or not income derived through a company is taxed in the same way as income derived directly by an individual. In order to resolve the above issue, one generally tends to assume that an individual investment in a company is portfolio e.g., small shareholding in a listed company. Second assumption is that the investment by a corporate resident in one country in corporate resident in another country is direct investment. Investment in the business by the company is also assumed as one form of direct investment through a branch. In multinational companies, there is different set up. In general, above three types represents tax compliance in vast majority of cross-border investments through companies. The main concern in all the above is international double taxation.

2. Issues of Double Taxation Involved

The issues involved in double taxation include: double taxation of company shareholder income and international double taxation. The term international double taxation means taxation in more than one country.

India has been acknowledged as sovereign republic in the preamble to the Constitution of India. Under Entry 14 of the Union List, the matter relating to “Entering into treaties and agreements with foreign countries and implementing of treaties agreements and conventions with foreign countries” have been included. Thus, the exclusive power of the Parliament to make laws with regard to entering into treaties and agreements is all encompassing and consequently, includes the power to legislate in this regard in the field of taxation of income.

This special power has been exercised by the Parliament by enacting Section 90 of the Income Tax Act, 1961. As per this Section, the Central Government has been empowered to enter into agreements with foreign countries for granting reliefs in respect of avoidance of double taxation so as to promote mutual economic relations, trade and investment. Central government has been empowered not only to enter into agreements for the avoidance of double taxation but also for exempting income from taxation. The effect of entering into these agreements provide that if no tax liability is imposed under the Act, then the question of resorting to the agreement would not arise. Where tax liability is imposed then the agreement may be resorted to for negating or reducing it. However, in case of difference between the provisions of the Act and of the agreement, the provisions of the agreement shall prevail over the provisions of the Act to the extent they are beneficial to the subject and shall be enforceable by the appellate authorities and the Court.

3. Involvement of Minimum Two Countries

There is a requirement of a minimum two countries as there is a possibility that the countries apply different tax systems and there is no uniformity among various tax systems. Thus, it becomes difficult as to which country’s tax system should effectively govern. There arises a necessity of having two perspectives that is one of the source country of the company and second that of the residence country to see how it relieves international double taxation. Such reliefs can be provided either by granting relief from corporate double taxation or by extending any such domestic relief to the international sphere. In the source country, the outcome shall depend upon how it taxes non-residents. The current international tax system as implemented in tax treaties is premised on the basis that the source country

can generally tax the company's income from the business carried on in that country in the same way as it taxes resident locally owned companies. The exception to this is most of the branch income of shipping and airline companies, which are not taxable in the country of the branch. In respect of the business carried out in the branch, the source country is obliged by the business profits article of tax treaties to apply corporate tax on a net basis. The source country is bound to follow tax treaties in respect of business branch or subsidiary form so as to eliminate discrimination against the non-resident owners and to apply the arm's length principle in determining the allocation of income between the source country and the residence countries because this system is entrenched by treaties.

CONSUMPTION TAXATION

The growing interest in consumption taxation can be explained by the substantial increase in international trade and cross border services during the last decade and by the new phenomenon of electronic commerce, both business to business and business to consumer. Consumption taxation has from early times when a part of goods sold by merchants had to be given to the rulers of the community where commerce was generally done. In 1900 BC, Assyrian caravans paid 2.9 per cent of the value of textile and tin upon exportation of these goods to neighboring States. In European countries sales taxes in spite of being an important source of revenue for local and national governments, lost favour in the 18th and 19th centuries, when the doctrine of ability to pay caused a shift toward taxing income and wealth. In Western Europe, the sales tax became unimportant in the beginning of the 20th century. A large number of countries introduced general sales taxes despite of great opposition after the economic crises of the 1930s as a temporary measure and after the World War II, their rates increased substantially.

In 1960s, sales or turnover taxes developed into consumption taxes in Europe. After a span of around three years after the foundation of the European Economic Community (1957), study group of the European Commission came to the conclusion that the classical system of sales taxes or turnover taxes, a cumulative system of taxes in almost all stages of production distribution, should be converted into a credit invoice method VAT (Value Added Tax) based on principles of internal and external neutrality. The term, "internal neutrality" meant that the burden of consumption tax shall be proportional to the price paid by the final consumer for goods and services, irrespective of the number of transactions during the previous stages

of the production and distribution process. The basic principle behind "external neutrality" was that the consumption tax in the country of consumption shall bear upon the goods or services and hence the revenues of the consumption tax accrue to the country of consumption. In the year 1967, the Council of EEC adopted the First (67/227/EEC) and Second (67/228/EEC) Directive of VAT containing the basic principles of VAT. The First Directive is still in force and but the Second Directive has been replaced by the Sixth VAT Directive (77/388/EEC), setting the rules for harmonization of the taxable base for the VAT.

The aim of consumption type of VAT is to tax all final consumption expenditures of goods and services so that final consumer bears the VAT charged to him by her supplier. It is leviable at each stage of the production and distribution process and in each stage the supplier of goods and services is liable for VAT.

In cross-border production and distribution chain, the credit invoice method of VAT follows the country of destination principle by applying zero rate tax for such transaction and levying VAT upon importation in the country of destination. In non-Vatable consumption taxes like, sales tax, the cascading effect of sales tax can be mitigated by applying an exemption of sales tax on supplies of goods and services to business customers.

VAT is in force in more than 130 countries ranging from Sri Lanka to China. India too has a VAT at the Central level (CENVAT).

VAT IN OTHER COUNTRIES

It shall not be an exaggeration to say that the emergence of the VAT as an important and elastic source of revenue over the last four decades is unparalleled in the history of taxation. Despite the widespread proclamation of VAT, there have been difficulties in implementing VAT in its true spirit in the countries like, Japan, Colombia, Russia, USA etc. Despite of such difficulties, it can be said with confidence that Value Added Tax system definitely has its advantages and is certainly recommended for most economies, particularly the developing ones.

VAT IN JAPAN

Japanese Ministry of Finance introduced national consumption tax in the year 1970 for the first time. It however took three tries due to massive public opposition which desired to reduce or suspend this consumption tax in order to stimulate the Japanese economy, before finally passing the law. Consumption

tax is a sales tax levied in Japan with main objective to tax consumer expenditure.

This consumption tax was designed in such a manner that it passed on to and is ultimately borne by the final consumer. The levy of this tax was at every stage of production and distribution. This tax used a credit method for intermediary businesses and in actual practice, it was to be added to the price of products sold and services provided by an enterprise. Thus, it provided an additional cost for the individual consumer. The system of consumption taxation in Japan allowed businesses to set off some or all of input tax that it suffers against the output tax collected with only the net amount having to be paid over to the government.

Under Japanese context, a tax payer for consumption tax purposes is an enterprise supplying taxable goods or services in the country above a certain limit for consideration. The term enterprise for the above purposes includes individuals as well as companies resident and foreign corporations.

The consumption tax on taxable purchases during a taxable period is classified into three groups namely, tax on taxable transactions, tax on non-taxable transactions and tax incurred on both taxable transactions and non-taxable transactions in common.

VAT IN COLOMBIA

In Colombia, VAT is an indirect tax and is applicable to sales of goods, services rendered within the national territory and imports of tangible movable assets. It does not apply to the sale of fixed assets except for sales of automobiles and airplanes and of other fixed assets sold in the name and on behalf of third parties.

The general VAT rate in Colombia is 16 per cent. VAT is equivalent to the difference between the tax generated by the taxed transactions and the tax credits that are legally deductible. VAT generated on taxable transactions is established by applying the rate of the tax to the taxable base and deducting VAT on returns and transactions rescinded, resolved or rendered void. VAT paid on the acquisition of goods and services up to the limit resulting from applying to the value of the transaction evidenced by the respective invoices, the tax rate on the activity that is being taxed, the portion exceeding this percentage shall constitute a higher value of the cost or of the respective expenditure.

VAT Credits in respect of acquisitions of goods and services and for imports are available only if it is incurred in respect of transactions, which are allowed as costs or expenses of the enterprise as per income tax laws.

Cross-border services in Colombia are subject to double taxation taking into account the services rendered in the country which are subject to VAT unless the relevant services are documented as exempt exports. So, the cross-border transactions shall be so structured that they amount to export of services in order to be exempt from VAT.

VAT IN GREECE

The principle of neutrality as laid out in article 2 of the Sixth Directive is adopted by the Greek VAT law. In Greece, VAT system was introduced by Law 1642/1986 which implemented the EC Council Directive 77/388/EEC "on harmonization of the laws of the Member States relating to turnover taxes-common system of Value Added Tax: uniform bases of assessment" (Sixth Directive). This law was amended number of times and the latest codification of Greek VAT law was effected by Law 2859/2000.

The method of taxation followed in Greece is credit invoice method besides special schemes introduced by various articles.

The standard fixed for VAT in Greece is eighteen per cent subject to certain exceptional items where reduced rates are made applicable for computing VAT. In the instances where a EU resident makes a taxable supply in Greece, he is required to get registered for VAT purposes through appointment of a representative, who is not a VAT representative and is not co-liable for the payment of VAT. On the contrary, where a non EU resident makes a taxable supply in Greece and does not have a permanent establishment, then he shall be required to get registered for VAT purposes through appointment of a VAT representative who shall be co-liable for the payment of VAT.

There is no concept of forming VAT Groups in Greece allowing Member States to consider and treat as a single taxable person, who are legally independent and are closely bound to one another.

VAT IN SOUTH AFRICA

In South Africa VAT is transaction-based tax. It was introduced in the year 1991 by implementation of Value Added Tax Act No. 89 of 1991. The levy of VAT extends to supply of goods and services by a vendor, who is a person registered for VAT in South Africa. There are two ways in which a person can register as a vendor. First is voluntary and second is compulsory. South African Revenue Services allocates different tax categories to the vendor on obtaining registration on the basis of tax supplies of the vendor during the course of the year ,

which are categories A, B, C, D. Generally, categories A and B are allocated to most of the vendors. In terms of these categories, tax returns are submitted every second month. Where turnover of a vendor exceeds R30 million in one year period, the vendors are required to get registered under category C. In this category, tax returns are submitted on monthly basis. Fourth category is category D which is available to farmers or farming enterprises on a total turnover of less than R1 million per annum. Under this category, the vendors are required to submit VAT returns on half yearly basis.

VAT is leviable on the supply of goods and services. The standard rate of tax in South Africa is 14 per cent. It is levied at each stage of a transaction. In a system of input tax claimable and output tax payable, it is the end consumer who bears the VAT burden. In cases of exempt supplies, the vendor shall not levy VAT on the supply or claim his input tax credit thereon.

VAT IN UNITED KINGDOM

In UK, VAT is based on invoice credit method and follows the European Union model. VAT in UK is a multistage and tax is charged and collected at each stage of the production and distribution cycle. There are two rates of VAT in UK. One is standard rate i.e., 17.5 per cent and another is reduced rate i.e, 5 per cent. It is a self assessed tax and the traders are entitled to certainty in dealing with their tax affairs.

The taxable person in the context of VAT is supplier of goods and services who shall obtain registration for VAT purposes and shall also be liable to pay tax. Refund of VAT is made to the traders on purchases of goods and services and on importations so that the tax is borne by the final consumer. There shall be no refund of tax to the traders if the goods and services are used to make exempt supplies.

The governing legislation in UK is EU Sixth Directive along with the national provisions implementing the directive. There have been numerous changes in the UK rules since the adoption of the Directive for computing relief for input tax for partly exempt traders. The amendments to the legislation have been made to bring harmonization and improvement in the accuracy of the computation of the relief. These regulations provide for a standard method for computing input tax deduction for partly exempt businesses but customs have the power to approve and devise special methods where the value of particular outputs could unfairly distort the computation of the input tax deduction.

UK recognizes registration of groups consisting of single taxable person as two or more companies under

common control. The general effect of grouping is that the supplies of goods and services between the group members are ignored for VAT purposes. One of the members is recognized as representative member who is responsible for all supplies to and by members of a VAT group. This has been done by traders for tax avoidance purposes. Recently, the financial institutions in UK have started using joint venture companies in VAT groups in order to reduce the VAT cost of outsourcing.

VAT IN UNITED STATES

There is no broad-based federal tax on consumption in United States. There exists single stage retail sales taxes in majority of the American States with an exception to two States where modified form of VAT exists that reaches some of the value added by financial institutions operating in that State. There is no border adjustable tax on consumption in U.S. In the year 1971, Congress enacted income tax reliefs for exporters tied to export sales receipts. The law of Domestic International Sales Corporation was modified and renamed over the next thirty years and in 2002, its successor legislation Foreign Sales Corporation Tax was held to be a prohibited subsidy under World Trade Organisation Rules. The report on consumption taxation explored the VAT with limited scope including cross-border transactions. This report does not mention VAT implications for a US company operating in a VAT country which is registered for VAT.

US major trading partners rely on destination principle to tax cross-border transactions. In case of imposition of VAT on cross border transactions under a normative destination principle tax base, there would be imposition on all imports of goods and services to be consumed domestically and all exports would have been free from tax. Thus, none of the forms of VAT in use today are imposed on this normative tax base.

VAT IN RUSSIA

In Russia, there are three main consumption taxes namely, excise tax, sales tax and VAT. Chapter 21 of the Russian Federation Tax Code which came into force on January 2001 regulates the VAT system in Russia by replacing the former federal law on VAT and the related legislative documents. It is a tax levied by the federal government and is payable to the federal budget only.

VAT obligations are determined by credit invoice system. For VAT purposes, the seller of goods and services and not the buyer is considered as a taxpayer. Taxpayers include Russian companies, foreign

companies, private entrepreneurs and small businesses including companies and private entrepreneurs whose gross proceeds net of VAT do not exceed 10 lac roubles.

Standard rate of VAT is 20 per cent, while a reduced rate of 10 per cent is applicable to certain types of goods. Export of goods and services is subject to VAT at a rate of 0 per cent.

VAT IN INDIA

In India, State-level VAT is a multi-point tax on value addition which is collected at different stages of sale with a provision for set-off for tax paid at the previous stages i.e., tax paid on inputs. It is to be levied as a proportion of the value added (i.e. sales minus purchase) which is equivalent to wages plus interest, other costs and profits. It is a tax on the value added and can be aptly defined as one of the ideal forms of consumption taxation since the value added by a firm represents the difference between its receipts and cost of purchased inputs. It is commonly referred to as a method of taxation whereby the tax is levied on the value added at each stage of the production and distribution chain. It intends to tax only the value added at each stage and not the entire invoice value of the product. By ensuring that only the incremental value is taxed, it aims at eliminating the cascading effect of taxes on commodities and reduces the eventual cost to the consumer.

It is one of the most radical reforms, albeit only in the sphere of State level taxes on sale, that have been initiated for the Indian economy after years of political and economic debate aiming at replacing complicated tax structure to do away with fraudulent practices.

With the objective to introduce State-Level VAT in India in the Year 1992, the Government of India constituted a Tax Reform Committee headed by Dr. Raja J. Chelliah. In 1993, the Committee recommended the introduction of VAT in place of existing tax system. Thereafter, the Government appointed NIPFP (National Institute of Public Finance and Policy), New Delhi, as the Nodal Agency to work out the modalities of VAT.

The first preliminary discussion on State-Level VAT took place in a meeting of Chief Ministers convened by Dr. Manmohan Singh, the then Union Finance Minister in 1995. In this meeting, the basic issues on VAT were discussed in general terms and this was followed up by periodic interactions of State Finance Ministers.

For implementing the above decisions, an Empowered Committee of State Finance Ministers was set-up. Thereafter, this Empowered Committee met frequently and got full support from the State Finance

Ministers, the Finance Secretaries and the Commissioners of Commercial Taxes of the State Governments as well as Senior Officials of the Revenue Department of the Ministry of Finance, Government of India. Through repeated discussions and collective efforts of all, it was possible to achieve remarkable success within a period of about one and half years. After reaching this stage, steps were initiated for the systematic preparation for the introduction of State-Level VAT.

Along with these measures ensuring convergence on the basic issues on VAT, steps were taken for necessary training, computerization and interaction with trade and industry, particularly at the State level. This interaction with trade and industry was specially emphasized. The conference of State Chief Ministers presided over by Shri Atal Behari Vajpayee, the then Prime Minister, held on October 18, 2002 at which Shri Jaswant Singh, the then Finance Minister was also present, confirmed the final decision that all the States and the Union Territories would introduce VAT from April 1, 2003.

The Empowered Committee of State Finance Ministers on February 8, 2003 again endorsed the suggestion that all the State legislations on VAT should have a certain minimum set of common features. Most of the States came out with their respective draft legislations. Shri Jaswant Singh the then Union Finance Minister, also announced the introduction of VAT from 1st April, 2003 in his 2003-2004 budget speech made on February 28, 2003. Owing to some unavoidable circumstances, VAT could not be implemented w.e.f. April 1, 2003 and also on the revised date June 1, 2003, Despite all obstacles, Haryana was the first State to implement VAT w.e.f. April 1, 2003. In rest of the States VAT Laws were at draft stage.

The Empowered Committee of the State Finance Ministers constituted by the Ministry of Finance, Government of India, on the basis of the resolution adopted in the conference of the Chief Ministers on November 16, 1999 under the Chairmanship of Dr. Asim Dasgupta came out with a White Paper on State-Level VAT, which was released on January 17, 2005 by Shri P. Chidambaram, The Finance Minister, Government of India. On this occasion, Finance Minister remarked:

“This is the first document which has been collectively prepared and put out to the people of the country by the Finance Ministers of all States.... We have formed the rainbow coalition to undertake one of the biggest tax reforms.”

This Paper consists of three parts. In Part I, justification of VAT and the background has been mentioned. In Part II, main Design of VAT as evolved on the basis of consensus among the States through repeated discussions in the Empowered Committee has been elaborated. In Part III, other related issues for effective implementation of VAT have been discussed.

The White Paper specified that registration under the VAT Act shall not be compulsory for the small dealers with gross annual turnover not exceeding Rs.5 lakh. However, the Empowered Committee of State Finance Ministers has subsequently allowed the States to increase the threshold limit for the small dealers to Rs.10 lakh, but the concerned State shall have to bear the revenue loss, on account of increase in the limit beyond Rs. 5 lakh. The VAT Acts are designed so that high value taxpayers should not be spared and on the contrary small dealers should be hassle free from compliance procedures.

The objective of all such composition schemes is not to burden small dealers by the provisions of record keeping. Therefore, such schemes will generally contain the following features:

- (i) small amount of tax shall be payable;
- (ii) there shall be no requirement to calculate taxable turnover;
- (iii) a simple return form to cover longer return period shall be sufficient.

All sales or purchases of goods made within the State except the exempted goods would be subjected to VAT as a consumption tax.

In his speech introducing Union Budget 2005-06, the Hon'ble Finance Minister said, "In a remarkable display of the spirit of cooperative federalism, the States are poised to undertake the most important tax reform ever attempted in this country. All States have agreed to introduce the value added tax (VAT) with effect from April 1, 2005. VAT is a modern, simple and transparent tax system that will replace the existing sales tax and eliminate the cascading effect of sales tax.

In the medium to long term, it is my goal that the entire production-distribution chain should be covered by a national VAT, or even better, a goods and services tax, encompassing both the Centre and the States.

The Empowered Committee of the State Finance Ministers, with the solid support of the Chief Ministers, has laboured through the last 7 years to arrive at a framework acceptable to all States. The Central

Government has promised its full support and has also agreed to compensate the States, according to an agreed formula, in the event of any revenue loss. I take this opportunity to pay tribute to the Empowered Committee, and wish the States success on the introduction and implementation of VAT".

EXTRACTS FROM KELKAR COMMITTEE REPORT

Considering that the implementation of VAT was closely linked to the administration of other indirect taxes and impacts the tax to GDP ratio, it had become necessary to examine the relevant issues. In this direction the Task Force has had the benefit of meeting with the Empowered Committee of the Finance Ministers of the States, constituted for the purpose of implementing a nationwide State-level VAT. The Empowered Committee experimented on federal fiscal planning and achieved much in terms of building a consensus on many of the critical issues relating to implementation of VAT in a relatively short spell of time. Most countries have taken several years to implement VAT. Decisions were taken on the important features of VAT relating to replacement of the State Tax levied by the States though some other local taxes like octroi, mandi, cess etc. may continue.

It was recommended that a publicity awareness programme shall be started jointly by the Central Government and the State Governments. The Central Government shall extend financial support for this, if needed. Since the State VAT is expected to be implemented from 1.4.2003, it is also necessary that the publicity awareness programme should be implemented at the earliest.

One of the issues which had impact on the transition of VAT was the compensation to be given to the States upon the removal of Sales-tax and the introduction of State VAT, in the event the tax revenue drops due to the change over. In this regard, it had been observed that the experience worldwide has been that a move towards VAT results in higher revenue realization.

During the meetings that the Task Force had with several industry and trade bodies, it was represented that the switch-over to VAT must ensure that the desired benefits are achieved, especially in view of the fact that this switch-over shall entail a major overhaul of systems and procedures for business and governments and at substantial expenditure of money, time and effort.

Under the existing sales-tax structure, there are problems of double taxation of commodities and multiplicity of taxes resulting in a cascading tax burden.

As per the existing structure before a commodity is produced, inputs are first taxed and then after the commodity is produced with input tax load, output is taxed again. This causes an unfair double taxation with cascading effects. In the VAT, a set-off is given for input tax as well as tax paid on previous purchases.

The design of State-level VAT had been worked out by the Empowered Committee through several rounds of discussions and striking a federal balance between the common points of convergence regarding VAT and flexibility for the local characteristics of the States.

Vat Liability

In India, the 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 tax collected on sales during the payment period (say, a month).

The White Paper specifies that registration under the VAT Act is not compulsory for the small dealers with gross annual turnover not exceeding Rs.5 lakh. However, the Empowered Committee of State Finance Ministers subsequently allowed the States to increase the threshold limit for the small dealers to Rs.10 lakh, but the concerned States will have to bear the revenue loss on account of increase in the limit beyond Rs.5 lakh.

VAT is so designed that high value taxpayers are not spared and on the contrary small dealers are also hassle free from compliance procedures.

Advantages

Introduction of VAT in India has many advantages i.e.,

- to encourage and result in a better-administered system;
- to eliminate avenues of tax evasion;
- to avoid under valuation at all stages of production and distribution;
- to claim credit of tax paid on inputs at each stage of value-addition;
- do away with cascading effect resulting in non distortion of the business decisions;
- permit easy and effective targeting of tax rates as a result of which the exports can be zero-rated;
- ensures better tax compliance by generating a trail of invoices that supports effective audit and enforcement strategies;

- contribution to fiscal consolidation for the country. As a steady source of revenue, it shall reduce the debt burden in due course;
- to help India to integrate better in the WTO regime;
- to stop the unhealthy tax-rate war and trade diversion among the States, which had adversely affected the interests of all the States in the past.

Methods of Computation

In India, computation of VAT can be done by using any of the following methods namely,

1. *The Subtraction method* : Under this method the tax rate is applied to the difference between the value of output and the cost of input;
2. *The Addition method* : Under this method value added is computed by adding all the payments that are payable to the factors of production (viz., wages, salaries, interest payments etc);
3. *Tax credit method* : Under this method, it entails set-off of the tax paid on inputs from tax collected on sales. Indian States opted for tax credit method, which is similar to CENVAT.

Procedure

In India, VAT is based on the value addition to the goods. Input tax credit is given for both manufacturers and traders for purchase of input or supplies meant for both sales within the State as well as to the other States irrespective of their date of utilization or sale. If the tax credit exceeds the tax payable on sales in a month, the excess credit will be carried over to the end of the next financial year. If there is any excess unadjusted input tax credit at the end of the second year then the same will be eligible for refund. For all exports made out of the country, tax paid within the State is refunded in full. Tax paid on inputs procured from other States through inter-State sale and stock transfer shall not be eligible for credit.

The existing Sales Tax Acts in all States shall give place to the State VAT Act. Accordingly the Rules, Schedules and Forms under the erstwhile Acts shall be abolished. However, Central Sales Tax shall continue to govern inter-State sales and exports.

Rates of Tax

As contrasted to the multiplicity of rates under the existing regime, there are four broad rates under VAT regime -0% (Exempted for unprocessed agricultural

goods, and goods of social importance), 1% for precious and semiprecious metals, 4% for inputs used for manufacturing and on declared goods, capital goods and other essential items, 20% for demerit/luxury goods and the rest of the commodities shall be taxed at a Revenue Neutral Rate of 10-12.5%.

Distinction between Existing System and VAT

Indian States continue to tax declared goods on single point basis under the existing system subject to a rate of 4%. Under VAT, declared goods shall also be subject to tax at multiple levels.

As per existing Sales tax law, inputs used for manufacture, whether capital or otherwise, are eligible for concessional rate of tax on furnishing the requisite forms. However, under the VAT system, there is no place for concessions. Goods are taxed at their respective rates with a provision for set off in future. There is no incentive scheme under VAT, barring those carried forward from the existing system.

Exports and supplies to exporters i.e. penultimate sales are exempt from tax under the existing system subject to certain conditions. Under VAT, exports are zero-rated i.e. they are not exempted, giving rise to refund of tax paid on inputs.

There is no set off of prior taxes paid under the existing system of Single Point Tax and Multi-point tax. In Single point Tax too, further taxation is effected by way of turnover tax and hence set off assumes relevance even in a single point tax system. In the VAT system, all prior taxes are given set off against output tax if the sale is not an exempt sale.

In VAT regime, the rates shall be uniform. However, it is possible that items under the exempted category and 4% category may be broadly similar across all States. Each State has its own VAT Act, Rules, Schedules, and Forms. Still there remain differences even in definitions among various Acts.

Petroleum products, like Aviation Turbine Fuel, Naphtha etc. used as fuel for running automobiles are brought under VAT, but credit cannot be taken on the tax paid thereon. Tobacco, Textiles and Sugar, which were under additional duty in lieu of excise and not under State taxation, are brought into the State Tax net at a rate not more than 4%, thereby integrating these products in the VAT structure.

Registration

Every dealer up to the retailer level is required to get registered with the Sales Tax department in order to

avail the credit of input tax. However, there is a threshold turnover level. The retailers with turnover below the threshold can opt not to register, but pay a nominal composition tax. However, such dealers are not entitled to take credit of prior stage tax, nor can they pass the credit to their buyers. In effect, the VAT chain breaks at that stage. Those opting not to register under VAT can opt for general registration.

Registration of dealers with gross annual turnover above Rs.5 lakh is compulsory. There is a provision for voluntary registration for dealers with gross annual turnover of less than Rs 5 lakh. All existing dealers get automatically registered under the VAT Act. A new dealer is allowed 30 days time from the date of his being liable to get registered.

Small dealers with gross annual turnover not exceeding Rs.5 lakh shall not be liable to pay VAT. States have flexibility to fix threshold limit within Rs.5 lakh. Small dealers with annual gross turnover not exceeding Rs.50 lakh who are otherwise liable to pay VAT, shall however have the option for a composition scheme with payment of tax at a small percentage of gross turnover. The dealers opting for this composition scheme shall not be entitled to input tax credit.

The entire design of VAT with input tax credit is crucially based on documentation of tax invoice, cash memo or bill. Every registered dealer, having turnover of sales above an amount specified, shall issue to the purchaser, who is entitled to tax credit and not to the final consumer, serially numbered tax invoice with the prescribed particulars. This tax invoice is to be signed and dated by the dealer or his regular employee, showing the required particulars.

Exempt Sale

When a certain sale is exempt from tax, the dealer effecting the exempt sale shall not be entitled to any VAT credit on the inputs purchased by him. The sales effected by him shall also be exempt from any tax. This results in breaking of the VAT chain.

Another example where reversal is made is when the goods are sold as samples or gifts i.e., non-taxable transactions and the input tax credit relating thereto have already been availed against output tax payable on other sale transactions. In such circumstances, the credit earned shall be reversed. This is called "Reverse Credit of Input Tax".

Stock or Consignment transfers are exempt from VAT as these were not under the purview of the State Tax Acts as well. The input tax paid on such commodities

or on the inputs that go into production of such commodities are available as credit to the extent of excess of input tax over and above 4%. Thus, if the inputs used in the commodity that is transferred, or the product itself when purchased, were taxed at 10%, credit can be taken by the transferring dealer to the extent of 6% against other taxable dispatches. Imported goods shall continue to be exempt from VAT on imports. Under VAT, there is no place for Entry taxes and Octroi.

Credit and Set-Off under VAT Regime

VAT aims at providing set-off for the tax paid earlier and this is given effect through the concept of input tax credit. 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.

Tax paid on the earlier point is termed as, "input tax". This amount is adjusted against the tax payable by the purchasing dealer on its sales. This credit availability is called input tax credit. "Input tax" is the tax paid or payable in the course of business on purchase of any goods made from a registered dealer of the State. "Output tax" means the tax charged or chargeable under the Act, by a registered dealer for the sale of goods in the course of business. In other words, input tax is the tax a dealer pays on his local purchases including the goods that he purchases for resale, raw materials, capital goods as well as other inputs for use directly or indirectly in his business. Output tax is the tax that a dealer charges on its sales that are subject to tax. The input tax credit is available for both manufacturers and traders for purchase of inputs or supplies meant for sale within as well as outside the States, irrespective of these being utilized or sold. This results in reduction of tax liability.

Input tax paid in excess of 4% is eligible for tax credit in respect of stock or consignment or branch transfers of goods out of the State. Partial input tax credit is also available in respect of inputs used for manufacture of exempted goods.

Input tax credit is allowable 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. Input tax credit on capital goods is available for traders and manufacturers.

Input tax paid under the VAT Act is eligible for being set off against Central Sales Tax payable on inter-State sales. Therefore, excess of input tax over and above the output tax payable under the VAT Act can be applied towards Central Sales Tax payable. While taxes paid on raw materials and inputs are eligible for set off against

taxes on output, taxes paid on capital goods are not eligible for immediate set-off. The reason perhaps is the huge credit that States may have to grant in cases of capital purchases of large value. Due to this, tax on capital goods may be granted, but over a certain period of time. However, the credit is limited only to capital goods actually used for manufacture and hence may not be available to a trader.

In some cases, the input tax paid and taken credit of may have to be reversed, for example, when the material is consumed for personal purposes and not business purposes, or when the input including packing materials is used for manufacture and/or sale as exempt goods etc.

All tax-paid goods purchased on or after April 1, 2004 and still in stock as on April 1, 2005 are eligible to receive input tax credit, subject to submission of requisite documents. In respect of resellers holding tax-paid goods on April 1, 2005, the input tax credit is given for the sales tax already paid in the previous year. This tax credit shall be available over a period of 6 months after an interval of 3 months needed for verification.

Assessment

The VAT liability is self-assessed by the dealer himself. It pre-supposes that all the dealers act in an honest manner. Scrutiny is done in cases where there are doubts arising due to under reporting of transactions or evasion of tax.

Audit

There shall no longer be compulsory assessment at the end of each year. Correctness of self-assessment is checked through a system of Department Audit. A certain percentage of the dealers are taken up for audit every year on a scientific basis. In case of detection of evasions during the course of audits, the concerned dealer may be taken up for audit for previous periods. This Audit Wing remain delinked from tax collection wing to remove any bias. The audit team conducts its work in a time bound manner and audit is completed within six months and the audit report is transparently sent to the dealer as well.

Simultaneously, a cross-checking through computerized system is done on the basis of coordination between the tax authorities of the State Governments and the authorities of Central Excise to compare constantly the tax returns and set-off documents of VAT system of the States and those of Central Excise. This comprehensive cross-checking

system helps in reduction of tax evasions and lead to significant growth of tax revenue.

Returns

The return filing procedures are designed in such a way that the compliance costs are minimum. A registered dealer is required to file a return along with the requisite details such as output tax liability, value of input tax credit, and payment of VAT.

Under VAT, there are simple forms of return, which are filed monthly, quarterly or annually as per the provisions of various State laws. Returns are accompanied with the challans evidencing payment of tax. In certain States, returns cum challan forms have been devised. In those cases, the returns along with the payment are required to be filed with the treasury.

Every return so furnished is required to be scrutinized expeditiously within the prescribed time limit from the date of filing the return. If any technical mistake is detected on scrutinizing, the dealer shall be required to rectify the defect or pay the deficit.

Zero Rating

Zero Rating means that the tax payable on sale of a commodity is fixed at 0%. Though apparently, it looks similar to an exempt transaction, there is a significant difference between the two. While in an exempt transaction, the tax paid on input lapses i.e., it cannot be set off, under the Zero rated sales. Prior stage tax is set off against the 0% tax paid and effectively the entire tax paid on purchases is eligible for refund. Thus, 'Zero Rating' is advantageous to the dealer compared to 'exempting' of sale transactions. Generally, export sales are zero-rated and thereby, exporters are granted refund of taxes paid by them on their inputs. Exporters gain significantly due to the 'Zero Rating'.

Refunds

Refunds are to be granted by the end of the financial year. Thus, the benefit of zero rating is not immediate, but deferred. Some States have also provided for refund where the tax paid on inputs exceeds the output tax payable and cannot be set off in a given period. In such cases, the excess tax not so set off shall be refunded after adjusting any dues towards interest, penalty etc, in accordance with the State VAT Act.

Goods and Service Tax

Conceptually although not presently so in India, VAT covers both tax on sale of goods and tax on services. In few countries such as, Singapore, Canada etc., it is known

as Goods and Service Tax. The Task Force headed by Dr. Vijay Kelkar had recommended a comprehensive goods and services tax.

Position of Company Secretaries in India

The profession of Practising Company Secretaries in India, which made a humble beginning in the sixties, has now reached greater heights. With the clear and blended knowledge of various laws that they possess have made firms of Practising Company Secretaries versatile professionals capable of rendering wide range of services in diversified fields through specialist partners who develop expertise in VAT.

Company Secretaries in Practice have now been recognized in India to act as an authorized representative for the purpose of appearing before VAT authorities under Statutes of various States as well, like; West Bengal Value Added Tax Rules, 2005 under Rule 2(1)(a)(iv) of the Rules; Bihar Value Added Tax Act, 2005, under Section 87(d) of the Act; Daman and Diu Value Added Tax Regulation, 2005, under regulation 82(1)(b) of the Regulation; and Goa Value Added Tax Act, 2005, under Section 82(1)(b) of the Act.

These States have begun the process of recognizing Practising Company Secretaries and others are bound to follow as VAT regime gets settled through out India.

In view of the Right to Information Act 2005 effective from October 12, 2005 recognising the right to information of the Citizens of India, company secretaries are now required to be more conscience keeper of the corporate affairs as their responsibilities have increased many folds in terms of filing of various important documents, records with Government bodies like, Commissioners, CBDT, CBEC, VAT authorities etc. Since the documents are of vital importance and depict insight of the company therefore, they are entrusted with greater responsibility so far as scrutinizing, filing and signing of the documents are concerned. This has placed company secretaries at an advantageous and responsible position adding further weightage to their roles in the changing scenario opening new vistas to the profession of Company Secretaries in India.

CONCLUSION

Initial tax revenue benefits can be reaped from extended geographic reach and from sharing capabilities in businesses that already have international elements. Longer-term revenue gains can arise from the transfer of capabilities in domestic as well as cross-border businesses. Once the institution has achieved substantial

size, the acquisition of large, competitively placed players in other countries becomes feasible.

Increasing liberalisation of the services sector has led to an urgent need for a review of indirect tax rules and VAT in particular. This is in order to ensure that such indirect tax rules are compatible with the need for correct and simple VAT taxation of such supplies. Most importantly, it should be clear to all market players what the consequences of VAT are, bearing in mind that indirect taxes are meant to be passed on to the consumer and should therefore in principle not create a burden for businesses.

Even, in certain EU countries as well, it has been felt that the unclear VAT treatment of certain transactions gives local tax authorities a certain freedom in their own interpretation often resulting in double taxation. Tax can no longer be taught or practised with a disregard for international tax and International tax can no longer be dealt with separately from domestic tax.

The major industrial powers, through the Organization for Economic Cooperation and Development (OECD), which is responsible for international tax treaties, have begun to focus on tax competition in the offshore tax havens.

At some point, this issue transforms from a tax competition to advanced economy protectionism with the rich nations seen as a tax cartel maintaining the poverty of poor nations. For instance, the U.S. can itself be seen as a tax haven with respect to its exclusion on taxing foreign investment income as well as its low income tax rates compared to many nations. It is critical to understand fully their own and their partner's policies in order to develop serving platforms with multi-country scope.

To facilitate cross-border planning for expatriates, the VAT planning team shall be quite different from the composition of the team required to engage in country-specific tax planning. Cross-border practices require a team of professionals to provide the necessary expertise.

Creating the appropriate team, involves forming strategic alliances with other professionals and using resources. Gaining access to cross-border planning expertise is an important issue. To perform well, the professionals need more specialization in VAT than just steady means. They must offer the potential services for, growth and improved profitability in existing businesses. Cross border entrepreneurs must look elsewhere for specialist partners to help in tax harmonization and expanding horizons. For example,

specialists not knowing what opportunities exist on the other side of the border, how the taxation system works or how their social security entitlements might be affected.

It is also true that the trails leading to cross-border taxation have been more thoroughly blazed in the path of future growth. Professionals need to pay a particular attention to the structure and flexibility of processing platforms to determine if any potential partners offer capabilities that would help them transform their tax policies.

Moving cross-border shall provide the specialists additional opportunities to reap the benefits of scale. Risk shall be diversified across markets and best practices be adhered to. The combination of large size and international scope of taxation can lower both overall costs and unit costs as activities shall move in most advantageous locations. If they move early, they will develop the experience and scale to be a regional and global tax consolidator. Once the professional specialists adopt cross border reach, they will tend to become a magnet for top talent and be well placed to capture the best tax governance opportunities. At the same time, they need to anticipate the changing tax strategies and consider what sort of services would allow them to build a competitively advantaged position to serve globally. While examining possible combinations, they need to have a clear vision of what new methodology could be followed.

The list of skills and technical knowledge required for cross-border consumption tax planning specialists is very vast, that is one of the reasons why we don't find many professionals specializing in this area. Cross-border specialists need to have a very strong technical and practical knowledge of a number of different areas (tax, legal, estate planning, immigration/emigration issues, etc.), on both sides of the border. In addition, a cross-border specialist needs to be able to integrate all of these areas into one cohesive plan.

New forces coming into play shall make cross-border consumption taxation more feasible and capable of creating value. As the international tax is removing old barriers, professionals are taking more global perspective, paying particular attention to VAT issues. The professionals that clear the cross-border hurdles will be able to gain and sustain competitive advantage in VAT regime. Obstacles there may be, but they are not insurmountable. To get started the professionals must concentrate and look at their current level of tax knowledge and determine how best they can improve further to serve globally.

In today's changing scenario, professionals that do not investigate cross-border VAT opportunities may end up alone as markets converge and national boundaries become less important. The danger of waiting too long to choose a specialist partner is that the attractive ones may quietly jump into the competition leaving others behind.

The cross-border practitioners need to be aware of compliance issues. If one is going to be working across borders there is a need to make sure that they are compliant with the different regulations to which their professional activities may subject them.

Since the key to growth as specialists under VAT regime is, to snatch opportunities internationally in order to have a competitive edge in dynamic cross-border environment. Therefore, it becomes imperative for us to ponder upon the following issues:

1. How do the specialists grow and become big in international scenario in the context of VAT regime ?
2. Will their position change within a span of few years if they stay the same size ?
3. Do they possess plans to make themselves attractive specialist partners ?
4. Do they need to be realistic about their domestic VAT scheme and about likely sources of growth. If the best opportunities clearly lie cross-border, do they have to compromise in order to integrate fully and achieve maximum benefits ?
5. Will the professionals be able to seize the cross-border opportunities, by assessing their current position and vulnerability ?
6. How would they feel if they achieve success in cross-border consumption taxation under VAT regime ?
7. Will the specialists be able to examine potential targets for cross-border taxation of equals in terms of possible synergies, value addition and development of future plans ?
8. Can the professionals quantify what additional skills and technical or non-technical competencies do they require while engaging in cross-border tax planning ?

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