Accounting for VAT

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1. Introduction

In the light of the salient features of VAT discussed earlier, the VAT is a procedure whereby a dealer can utilize credit for tax paid on inputs or supplies against tax payable on sales. Under the VAT, credit in respect of purchases made during a period can be set-off against the tax payable on sales during that period, irrespective of when the supplies or inputs purchased are utilized or sold. This implies that VAT credit is a credit on purchase of inputs or supplies and a dealer becomes entitled to it immediately upon making a purchase. Therefore, the dealer does not have to wait for the sales to be made or the purchased goods to be used for production to claim VAT credit. Further, there is no relationship between the inputs and the outputs, if all sales are taxable.

2. Records to be maintained

Maintenance of proper and complete records are first and most essential step towards proper accounting. **Sec 63** of the ACT provides for maintenance of true accounts of the value of goods sold or purchased by a dealer liable to pay tax under the Act. However, no list of books is prescribed. So the trader must keep sufficient records to ensure that VAT liability can be readily assessed. Moreover, records must be complete and appropriate to support all tax credit that may

be claimed. Therefore, at the minimum the dealer is required to maintained following mandatory records/ MIS Reports through ERP at it's principal place of business under VAT law:

- Purchase record showing details of purchases on which Tax has been paid, purchase made without payment of tax, purchases from exempted unit and purchase made from outside the state. Original tax invoice for purchases on which tax has been paid and invoices for purchases made without payment of tax shall be preserved date wise and in numerical order;
- Sales record showing separately sales made at different tax rates, zero-rated taxable sales and tax-free sales. Copies of tax invoices related to taxable sales and invoices related to exempt sales shall be retained date wise and in numerical order;
- Record of inter-state sales and inter-state stock transfer or transfer to job worker / loan licensee/ contract manufacturer supported by statutory declaration and such other evidences as may be relevant;
- A monthly account specifying total output tax, total input tax and net tax payable or excess tax credit due for carry forward;
- Details of input tax calculation;
- Stock record showing stock receipt and deliveries and manufacturing records;
- Stock record showing separately the particulars of goods stored in cold storage, warehouse, godown or any other place taken on rent;) Annual accounts including trading profit & loss account and the balance sheet;
- Bank records including statement, cheque book counter foils and pay-in slips;
- Cash book, daybook and ledger;
- Copy of all challans, evidencing payment of tax, interest or any other amount due;

3. **Accounting for VAT**

The Council of Institute of Chartered Accountants of India has issued GN (A) 19 (Issued 2005) Guidance Note on Accounting for State-level Value Added Tax, to provide guidance in respect of accounting for various aspects of State-level Value Added Tax, including accounting for credit/set-off available for input-tax paid on purchases and accounting for VAT payable on sales.

Before proceeding to the accounting treatment for VAT, it would be useful to understand the requirement of accounting standards pertaining to inventory and fixed asset. As per paragraphs 6 of *Accounting Standard (AS) 2* '*Valuation of Inventories*', issued by the Institute of Chartered Accountants of India, the cost of inventories should comprise all costs of purchases, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Further, the paragraph 7 of the AS 2 states that the costs of purchase consist of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase.

It should be noted here that the paragraph related to 'costs of purchase', according to which, only those taxes have to be included as costs of purchase which are not subsequently recoverable by the enterprise from the taxing authorities. Since the tax paid on inputs is available for set-off against the tax payable on sales or is refundable, it is of the nature of taxes recoverable from taxing authorities and accordingly, input tax paid should not be included in the costs of purchase. However, if the purchases are used in making exempt sales, or sales outside the state of Maharashtra, only a portion of credit would be allowable for set off and hence it should be appropriately adjusted.

3.1. Accounting treatment for VAT paid on purchases

The amount of tax paid on purchase of inputs or supplies and available for VAT credit should be debited to a separate account, say, VAT Credit Receivable (Inputs) Account. As and when VAT credit is actually utilised against VAT payable on sales, appropriate accounting entries will be required to record the adjustment, i.e., VAT Credit Receivable (Inputs) Account should be credited with a corresponding debit to the account maintained for tax payable on sales. The debit balance in VAT Credit Receivable (Inputs) Account, at the year-end, should be shown on the 'Assets' side of the balance sheet under the head 'Loans and Advances'

For example (a): A dealer purchases the following goods in a State during the month of March 2007:

- 4% VAT Goods For Rs.2,08,000 (Incl. Input Tax of Rs. 8,000)
- 12.5% VAT Goods for Rs. 1,80,000 (Incl. Input Tax of Rs.20,000)
- VAT Exempt Goods for Rs.1,00,000

Therefore, Total Input Tax of Rs. 28,000 is paid which is eligible for VAT credit. The purchase exclusive of Input Tax would be Rs. 2,00,000+1,60,000+1,00,000=4,60,000

The Accounting entry for recording the above purchases would be:

4% VAT Goods Purchase A/c	Dr.	Rs. 2,00,000	
12.5 % VAT Goods Purchase A/c	Dr.	Rs. 1,60,000	
VAT Exempt Goods Purchase A/c	Dr.	Rs. 1,00,000	
VAT Credit Receivable (Inputs) A/c	Dr.	Rs. 28,000	
To Bank/ Creditors A/c			Rs. 21,40,000

(Being goods purchased and input tax paid)

A dealer may purchase certain common inputs which are to be used for making taxable sales as well as for making exempt sales. In such a case, the dealer, on the date of purchase, should estimate inputs expected to be used for making taxable sales and for making exempt sales. The dealer should recognise VAT credit only in respect of those inputs which are expected to be used for making taxable sales and no VAT credit should be recognised in respect of inputs expected to be used for making exempt sales. Subsequently, in case the actual use is different from the estimated use, the dealer should pass an appropriate adjustment entry for the same. Similarly, in the case of stock transfer/consignment sale of goods out of the State where VAT credit is available only to the extent of a certain portion of input tax paid, the dealer should make an estimate of the expected stock transfers/ consignment sales and account for accordingly

3.2. Accounting treatment for VAT paid on Capital Goods

Accounting Standard (AS) 10 Accounting for Fixed Assets, issued by the Institute of Chartered Accountants of India, provides that “the cost of an item of fixed asset comprises its purchase price, including import duties and other nonrefundable taxes or levies and any directly

attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price. …". VAT credit is considered to be of the nature of a refundable tax. Therefore, the tax paid on purchase of capital goods should not be included in the cost of such capital good.

Under MVAT Act, 2002, the VAT credit is available on most capital goods. However, the VAT credit in not allowed for purchase of office equipments, furniture, fixture and electrical installation if they are purchased between 1st April 2005 to 7th September, 2006. Since the credit is available immediately, the amount in respect thereof should be debited to an appropriate account, say, 'VAT Credit Receivable (Capital Goods) Account'. Depreciation should be charged on the original cost of fixed asset excluding VAT credit.

For example(b): suppose a dealer purchases a machinery for Rs. 26,000 after paying Input Tax @ 4% which is used in manufacture. The accounting entry for this purchase of machinery would be:

Machinery A/c	Dr.	25,000	
VAT Credit Receivable (Capital Goods)A/c	Dr.	1,000	
To Bank/ Creditors			26,000
(Being Machinery Purchased)			

Any balance in the VAT Credit Receivable (Capital Goods)at the end of the year is shown in the as assets in balance sheet under *Loans and Advances*.

3.3. Accounting entries for VAT on Sales

VAT is collected on sales at each point of distribution chain. Although, it paid by the selling dealer it is borne by the customer. It is to be note that the amount collected by the dealer in respect of VAT on sales cannot be treated as income of the dealer as it is collected on the behalf of the government. Here, the definition of term 'income in *The Framework for the Preparation and Presentation of Financial Statements*, issued by the Institute of Chartered Accountants of India, is relevant which states that "Income is increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.".

The Value Added Tax (VAT) is collected from the customers on behalf of the VAT authorities and, therefore, its collection from the customers is not an economic benefit for the enterprise and it does not result in any increase in the equity of the enterprise. Accordingly, it should not be recognised as an income of the enterprise. Similarly, the payment of VAT should not be treated as an expense in the financial statements of the enterprise.

Considering the above principles, the amount collected as VAT from customer should be segregated from the sales and should be credited to an appropriate account, say, 'VAT Payable Account'.

For example (c): suppose the sales made by a dealer in month of March,2007 is as follows:

- 4% VAT Goods total amount received Rs 2,28,800 (incl. VAT Rs. 8,800)
- 12.5% VAT Goods total amount received Rs,2,02,500(incl. VAT Rs. 22,500)
- VAT Exempt Goods Rs 50,000

Therefore, total consideration received would be 2,28,800 + 2,02,500 + 50,000 = Rs. 4,81,300. It includes the VAT collection of Rs. Rs. 31,300.

The accounting entry for the above sales would be

Bank/ debtors A/c Dr.	Rs. 4,81,300		
To 4% VAT Goods Sales A/c		Rs. 2,20,000	
To 12.5 % VAT Goods Sales A/c		Rs. 1,80,000	
To VAT Exempt Goods Sales A/c			Rs. 50,000
To VAT Payable A/c			Rs. 31,300

(Being goods sold and VAT collected)

Any balance in VAT Payable account at the year end should be shown in the current liability as dues to government in the balance sheet.

Accounting for Debtor becoming Insolvent: if a debtor to whom goods are sold becomes insolvent in other words the debts are to be written off as bad, the entries should be reversed. For example in the above mentioned illustration suppose all the 4% VAT Goods Sales were made to

one party Ms X Ltd, who is declared insolvent and debt to him as bad on 30th June the following entries would be passed:

VAT Payable A/c	Rs. 8,800	
Bad Debts A/c	Rs. 2,20,000	
To Ms X Ltd.		Rs. 2,28,800

(Being bad debts written off on Ms X Ltd becoming insolvent)

3.4. Accounting entries for VAT credit on Opening Stock at inception of VAT scheme

Rule 51 of the MVAT Rules,2005 allows the claim and grant of set-off in respect of the purchases held in stock at the appointment date. Herein, a dealer is allowed set off of tax paid under earlier sales tax acts applicable on the tax paid inputs lying in the stock, on fulfillment of certain conditions.

The amount of VAT credit available in respect of opening stock should be credited to 'VAT Credit Available on Opening Stock Account' at the inception of the VAT scheme, if required documents for availing this credit are available with the dealer. The corresponding debit for this amount should be given to 'VAT Credit Receivable (Inputs) Account' if the VAT credit is available immediately. If the VAT credit is not available immediately but is available in future, the corresponding debit for this amount should be given to 'VAT Credit Deferred (Opening Stock) Account'. Subsequently, when this credit becomes actually available, the appropriate adjustment for the same should be made, i.e., the amount of credit becoming available should be credited to 'VAT Credit Deferred (Opening Stock) Account' with a corresponding debit to 'VAT Credit Receivable (Inputs) Account'. In the profit and loss account, the amount of 'VAT Credit Available on Opening Stock Account' should be shown as a deduction from the value of opening stock.

3.5. Accounting Entry for Adjustment of VAT credits

A dealer utilizes the VAT credit receivable balance pertaining either to inputs or to capital goods for adjusting or setting-off its liability in respect of VAT payable on sales or liability in respect

of disallowance /withdrawal of VAT credit. All liabilities adjusted out of the VAT credit receivable balance should be credited to the VAT Credit Receivable (Inputs) Account or VAT Credit Receivable (Capital Goods) Account. The corresponding debit for the same should be given to the account maintained for recording VAT liability on sales, say, 'VAT Payable Account', if the liability for VAT payable on sales has been met by using the balance in the said account.

For example(d): considering the facts of example (a), (b) & (c) the adjustment entry would be

VAT payable Account	Dr.	Rs. 29,000	
To VAT Credit Receivable (Inputs) A/c			Rs. 28,000
To VAT Credit Receivable(Capital Goods) A/c			Rs. 1,000

(being liability on VAT payable met from VAT credit available on input and capital goods)

In this case the total VAT Payable was Rs. 31,300 whereas the credit available was Rs. 29,000. Hence, the balance of Rs 2,300 will be shown in the liability side of the balance sheet as current liability.

3.6. Accounting for Disallowance or Withdrawal of VAT Credit

If the amount is utilized from the VAT Credit Receivable on Input for adjusting any disallowance /withdrawal of VAT credit taken on purchase of inputs made during the year, the same should be added to the cost of inputs. Appropriate adjustment in that case would have to be made while valuing inventory of inputs. If the amount adjusted pertains to disallowance/ withdrawal of credit in respect of purchases effected in earlier years, the accounting treatment would depend on whether the said inputs/ supplies are available in stock or not. If they are not available, i.e., these have already been sold, the disallowance/withdrawal should be debited to profit and loss account and treated as expense of the current year. If these are still lying in stock, the amount should be added to the cost of inputs.

For example : If the dealer made a stock transfer of 12.5% VAT goods costing Rs. 2,00,000 out of the State. The stock transfer was an exceptional case for the dealer and, therefore, he had not made an estimate in this regard at the time of purchase. VAT credit to the extent of 3% is not allowed on stock transfer as per the MVAT rules. Since the dealer has recognised full VAT credit at the time of purchase, he is required to reverse the VAT credit to the extent of 3% at the

time when the stock transfer takes place. The dealer passes the following entry to record the reversal amounting to Rs. 6,000 (Rs. 2,00,000 x 3%):

12.5 % VAT Goods Purchase A/c	Dr.	Rs. 6,000	
To VAT Credit Receivable (Inputs) A/c			Rs. 6,000
(Being VAT Credit reversed to the extent of 3% on stock transfer)			

If in the above case the, the inputs are not available in the stock the entry would be

Profit and loss A/c	Dr.	Rs. 6,000	
To VAT Credit Receivable (Inputs) A/c			Rs. 6,000
(Being VAT Credit reversed to the extent of 3% on stock transfer)			

3.7. Accounting for Refund of VAT

Section 51 of the MVAT Act, 2002 provides for the refund of the Input tax that cannot be adjusted against the VAT payable. Any refund of input tax received in this manner should be credited to the VAT Credit Receivable (Inputs) Account or VAT Credit Receivable (Capital Goods) Account, as appropriate.