

# **Value Added Tax Accounting: Concepts And Issues**

**Dr. K. Shankaraiah**

College of Commerce & Economics, Sultan Qaboos University

**D.N. Rao**

College of Commerce & Economics, Sultan Qaboos University

## **Abstract**

The Value Added Tax Accounting (VATA) is one of those newly emerged concepts, which were emphasized much in the context of VISION 2020 by the industry, business, profession, academic, administration, politicians etc. as VATA is regarded as a source of stable revenue, conducive to investment, immune to lobbying pressures and ensures the economic growth, which is also evident from the successful introduction of VATA by developed countries.

The concept and issues are presented in this paper to make the people aware of the VATA and remove the misconceptions or notions about VATA and to draw the attention and participation of the different sections of the society for strengthening the VATA system.

**Keywords:** VATA, issues, resistance, constitution, administration, political, harmonisation

## Value Added Tax Accounting: Concepts And Issues

Dr. K. SHANKARAI AH\*  
D.N. RAO\*\*

requirements of the present changed competitive economic environment and complex The accounting systems and procedures have been undergoing various changes to meet the system of industry and its scope has been broadened day by day. During this process of change, various concepts and issues involved in accounting have been emerged. The **Value Added Tax Accounting (VATA)** is one of those newly emerged concepts, which were emphasized much in the context of VISION 2020 by the industry, business, profession, academic, administration, politicians etc. as VATA is regarded as a source of stable revenue, conducive to investment, immune to lobbying pressures and ensures the economic growth, which is also evident from the successful introduction of VATA by developed countries. Specifically, the World Bank has been conducting various workshops to motivate the developing countries towards the implementation of harmonized VATA system in all states, in a phased manner with the active participation of businessmen, politicians, bureaucrats, professionals, academicians etc. In this context, the concept and issues are presented in this paper to make the people aware of the VATA and remove the misconceptions or notions about VATA and to draw the attention and participation of the different sections of the society for strengthening the VATA system.

### **VATA:**

VATA is an accounting system, which is based on the Value added and the tax on such Value Added. Here, Value Added in simple terms is the difference between sales and purchases or output value and input value. The tax collected on sales minus tax paid on purchases is known as Value Added Tax (VAT). The VATA system, in the present complex economic environment is preferred to various other systems by many of the industrialized countries.

Any new system emerges from the defects of the existing systems. The VATA is also emerged from the drawbacks of existing various multiple or single stage sales tax accounting systems. The existing most used multistage tax accounting system i.e. Turnover Tax<sup>1</sup> is abandoned by all industrial countries<sup>2</sup>, as it give rise to serious economic distortions, such as, tax cascading, incentives for vertical integration, no uniformity in effective tax burden across different products, biases in application of tax to imports and exports.

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\*Assistant Professor, Accounting Diploma, College of Commerce & Economics, Sultan Qaboos University, PB 20, PC 123, Al Khod, Muscat, Sultanate of Oman.

\*\*Lecturer, Accounting Diploma, College of Commerce & Economics, Sultan Qaboos University, PB 20, PC 123, Al Khod, Muscat, Sultanate of Oman

1. Tax on each sale, with no credit for the tax paid at earlier stages.
2. World Bank Seminar on VAT, p.7.

The Countries like, Canada, Japan, Switzerland, U.K., Denmark, Newzealand, Sweden, Norway, Iceland, Ireland and many other countries have replaced the single stage taxes, such as, manufacturer's tax, whole sale tax, retail sales tax, excise tax, as they are also prone to various problems, like, difficulty in defining them in the context of modern economies, creation of competitive distortions, leading to tax cascading and ineffectiveness in applying it to services etc.

On the other hand, the VATA, which is an accounting system that considers tax on each sale or resale with a credit / refund of tax paid on purchases for use in taxable activities, is adopted by many industrial countries, and is proved as a stable revenue source system, economically the most neutral and efficient form of tax, avoids the creation of any incentives for vertical or horizontal integration, eliminates the tax cascading, ensures neutral treatment of exports and imports, makes the tax burden independent of the trade / distribution channels etc. in simple terms, the system may be regarded as an effective balancing productive system.

The following table compares the different tax systems:

<b>Comparative Taxes</b>				(Tax @ 20%) (Rs.)		
Stage	Cumulative value of the supply	Turnover Tax	Retail Sales Tax	VAT		
				on sales(a)	on purchases(b)	Net(a-b)
I	100	20	—	20	-	20
II	150	30	-	30	20	10
III	300	60	-	60	30	30
IV	400	80	80	80	60	20
Total		190	80			80

The above table reveals that the tax under VATA system is lesser and proportionately distributed over the different stages, hence the risk in imposing the tax at one point is eliminated and no one is over burdened. Where as, the other systems lead to tax cascading and over burden on one party, which in turn leads to frauds and avoidance of tax. Hence, the VATA is a systematic system that not only ensures simplicity and equity, but also establishes the self-mechanism of cross checking of invoices, as they are required for claiming the tax credit for their purchases. The VATA also minimizes the lobbying of businessmen and ensures fair implementation of tax laws.

The table also explains the method of calculation of VAT, which is very simple to understand and compute, as it involves calculation of tax on sales (output) and deduction of tax on purchases (input), known as tax credit, from tax on sales.

***The formula for computing VAT for any business is as follows:***

$$\text{VAT} = \text{Tax on Sales} - \text{Tax on Purchases}$$

**ISSUES:**

Though the system is effective and simple, it is not immune from some issues or limitations. The basic issues, which are causing hurdle in the implementation of VATA, are summarized below and an attempt is also made to suggest the ways to over come such hurdles at the appropriate places.

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**Resistance:**

Any new system may have resistance in the beginning from various corners. But, the properly designed system and well communication of it to the concerned parties may help the tax engineers to over come this barrier. More over, as the change in environment is inevitable for any growth in economy, it has to be positively viewed and properly encouraged.

**Constitution:**

The introduction and adoption of this system require some constitutional amendments and enactment of certain laws to replace the existing system. A debate on this issue by inviting the participation of various knowledgeable

People from the different areas, may be useful to frame suitable laws, which in turn provide a basis for the constitutional amendments.

**Administration:**

Deviation from the conventional system may lead to the fear of difficulty in administration. But, the training to the administrative personnel, inviting their participation in simplifying the procedures, the introduction and increasing the use of computers definitely ease the problem and motivate the administration towards the implementation of VATA. Particularly, the computerisation of the process of tax

accounting reduces the fraud, workload and ensures the authenticity by providing the cross check.

**Political:**

Lack of awareness of mechanism and results of VATA may cause to misunderstanding among the politicians, as they may have a fear of loss of revenue to the exchequer. A proper exposure of the concept may turn off their negative view of the politicians, as the system ensures economic efficiency, equity, more revenue, avoidance of tax cascading etc. in the long run.

**Harmonization:**

The promotion of international marketing depends upon the harmonization of tax accounting standards of different states or countries. Like, the international law or international accounting standards, the uniform tax accounting norms with a slight rate variations based on their own circumstances are required, as it ensures clear and simple understanding of tax accounting systems of each other and makes them to feel comfort in calculating and estimating the tax burden, which in turn leads to more compliance.

Thus, a properly designed, well-communicated, simple, understandable VATA system would solve the issues involved in the implementation of VATA and make the system more effective.

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**CONCLUSIONS:**

It is true that in a game, one gain means the other loses. Where as, in VATA system, there is no loser or gainer. In fact, every one will be a gainer as the system in the long run ensures economic efficiency, equity, more revenue, simplicity, transparent, avoidance of tax cascading, self detection of frauds, free flow of information, more awareness etc. Above all, in the present era, many industries and states are adopting value addition as

their main goal and also as effective criteria for evaluating their efficiency, hence VATA has more importance and relevance in the present free global competitive environment. Though it has certain constitutional, legal, political, administrative, financial, contractual, trade barriers, a systematic planning of VATA administration definitely helps to overcome these barriers. A step towards VATA may lead to the harmonization of standards of tax, which in turn, promote the international marketing, as it ensures the proper understanding of tax policies and promotes the global trade. Hence, the keen attention of various thinkers and executives is invited to make the VATA system as an effective balancing productive system.