Tamil Nadu joins the VAT club

Positive for the companies in the state

VAT, or the value-added tax as it is popularly known, is clearly gaining ground, with Tamil Nadu state government also deciding to implement the new taxation system in the state from the first day of the next year. VAT, which seeks to simplify the tax structure and create a uniform common market within the country, replaced the sales tax in India on January 4, 2005. It was adopted by all but three states though: Tamil Nadu, Pondicherry and Uttar Pradesh. Now even Tamil Nadu has jumped on the VAT bandwagon. The development calls for a relook at the new taxation system.

Under the single-point system of tax levy currently followed in the states like Tamil Nadu, the manufacturer or importer of goods into a state is liable to pay a sales tax. There is no sales tax on the further distribution channel(s). VAT, in simple terms, is a multi-point levy on each of the entities in the supply chain with the facility of a credit on the input tax paid. In other words, it is the tax paid only on the value addition in the hands of each of the entities in the chain. For instance, if a dealer purchases goods then:

the purchase price	= Rs100
the tax paid on the purchase	= Rs10 (input tax)
the sale price	= Rs120
the tax payable on the sale price	= Rs12 (output tax)
the input tax credit	= Rs10
the VAT payable	= Rs 2

VAT is payable only on the value added to the product at every point of sale and not on the entire value of the goods. Under VAT, there is no additional surcharge tax or turnover tax. Hence, the tax burden of a producer or importer is less under VAT.

Tax rates in Tamil Nadu

Under the present tax system followed in Tamil Nadu, tax is levied on inputs at a concessional rate of 3%, which is not refunded. Manufactured product is taxed at various rates ranging from 4%, 10%, 12% to 16% and 20% at the first point of sale. Resale tax at 1% is collected at the second and subsequent sale points. Besides the above levy, the manufacturer has to pay a surcharge tax at 5% on the tax paid and an additional sales tax at 1-3% depending upon his turnover in the year. The seller can collect the tax from the buyer and pay the same to the government. But he cannot collect the additional sales tax.

Under VAT, there will be only three rates of taxation: 1%, 4% and 12.5%. There will not be any surcharge tax or additional sales tax.

Gold and silver bullion, and jewellery will be taxed at 1%. Basic goods and commodities, such as medicine and drugs, all agricultural and industrial inputs, capital goods and declared goods will be taxed at 4%. All the other items including cement will be taxed at 12.5%.

We have tried to evaluate the impact of this development on the companies under our coverage based in Tamil Nadu.

Under the present tax system, tax on inputs (raw materials, consumables etc) is collected at a concessional rate of 3% for use in manufacture. This tax on inputs is not refunded or set off against the tax payable on the sale of the finished product. Under VAT, the rate of taxation of industrial inputs will be 4%. The manufacturer will be given the facility of deducting the input tax paid by him against the tax payable on the sale of the finished product.

Impact on stocks in Sharekhan universe

Company	Impact	Extent	Remarks
Ashok Leyland	Positive	Rs20-25 crore pa	The benefit will accrue on account of credit on inputs and savings of the additional sales tax on turnover paid at the rate of 1-3%. The company derives approx. 18% of its volume sales from Tamil Nadu.
Sundaram Clayton	Positive	n.a.	The benefit of the input cost credit will be positive for the company. Majority of the company's sales are outside Tamil Nadu.
TVS Motors	Positive	Rs16-20 crore pa	The company will benefit on account of input cost credit. It has exemption from additional sales tax on turnover.
Orchid Chemicals and Pharmaceuticals	Neutral	-	The company derives only 16% of its sales from the Indian market. Consequently domestic sales from Tamil Nadu should be marginal.
Madras Cement**	Marginal	-	The savings that the company will enjoy on account of reduction in the tax on the selling price will be offset by the tax that will now be payable on the freight component. Thus the impact on the company's earnings will be negligible.*
India Cements**	Marginal	-	The savings that the company will enjoy on account of reduction in the tax on the selling price will be offset by the tax that will now be payable on the freight component. Thus the impact on the company's earnings will be negligible.

*The company will still continue to enjoy the sales tax deferral incentive till FY2009.

**There will be no major savings in input tax as the same is negligible for the cement industry.

The author doesn't hold any investment in any of the companies mentioned in the article.