

TAXATION FOR MANAGERS

PGDF-204

BLOCK 1: BASICS OF INCOME TAX

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TAXATION FOR MANAGERS



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ROLE OF SELF INSTRUCTIONAL MATERIAL IN DISTANCE LEARNING

The need to plan effective instruction is imperative for a successful distance teaching repertoire. This is due to the fact that the instructional designer, the tutor, the author (s) and the student are often separated by distance and may never meet in person. This is an increasingly common scenario in distance education instruction. As much as possible, teaching by distance should stimulate the student's intellectual involvement and contain all the necessary learning instructional activities that are capable of guiding the student through the course objectives. Therefore, the course / self-instructional material are completely equipped with everything that the syllabus prescribes.

To ensure effective instruction, a number of instructional design ideas are used and these help students to acquire knowledge, intellectual skills, motor skills and necessary attitudinal changes. In this respect, students' assessment and course evaluation are incorporated in the text.

The nature of instructional activities used in distance education self-instructional materials depends on the domain of learning that they reinforce in the text, that is, the cognitive, psychomotor and affective. These are further interpreted in the acquisition of knowledge, intellectual skills and motor skills. Students may be encouraged to gain, apply and communicate (orally or in writing) the knowledge acquired. Intellectual-skills objectives may be met by designing instructions that make use of students' prior knowledge and experiences in the discourse as the foundation on which newly acquired knowledge is built.

The provision of exercises in the form of assignments, projects and tutorial feedback is necessary. Instructional activities that teach motor skills need to be graphically demonstrated and the correct practices provided during tutorials. Instructional activities for inculcating change in attitude and behavior should create interest and demonstrate need and benefits gained by adopting the required change. Information on the adoption and procedures for practice of new attitudes may then be introduced.

Teaching and learning at a distance eliminates interactive communication cues, such as pauses, intonation and gestures, associated with the face-to-face method of teaching. This is particularly so with the exclusive use of print media. Instructional activities built into the instructional repertoire provide this missing interaction between the student and the teacher. Therefore, the use of instructional activities to affect better distance teaching is not optional, but mandatory.

Our team of successful writers and authors has tried to reduce this.

Divide and to bring this Self Instructional Material as the best teaching and communication tool. Instructional activities are varied in order to assess the different facets of the domains of learning.

Distance education teaching repertoire involves extensive use of self-instructional materials, be they print or otherwise. These materials are designed to achieve certain pre-determined learning outcomes, namely goals and objectives that are contained in an instructional plan. Since the teaching process is affected over a distance, there is need to ensure that students actively participate in their learning by performing specific tasks that help them to understand the relevant concepts. Therefore, a set of exercises is built into the teaching repertoire in order to link what students and tutors do in the framework of the course outline. These could be in the form of students' assignments, a research project or a science practical exercise. Examples of instructional activities in distance education are too numerous to list. Instructional activities, when used in this context, help to motivate students, guide and measure students' performance (continuous assessment)



PREFACE

We have put in lots of hard work to make this book as user-friendly as possible, but we have not sacrificed quality. Experts were involved in preparing the materials. However, concepts are explained in easy language for you. We have included many tables and examples for easy understanding.

We sincerely hope this book will help you in every way you expect.

All the best for your studies from our team!



TAXATION FOR MANAGERS

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TAXATION FOR MANAGERS

BLOCK 1: BASICS OF INCOME TAX

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BLOCK 1: BASICS OF INCOME TAX

Block Introduction

In this block we will study about our Income tax Act which is considered to be one of the most complicated acts in India. Most of the time students have been found running away from this subject. The writer has tried his best to explain the topics in very easy language and in most interesting ways. Sufficient illustrations and pictures have been added to make the content more interesting and easily understandable.

The first block has been divided into three units where unit one covers the basics concepts of income tax act and even gives an overview of the act. It covers meaning and definition of Taxation, characteristics of Taxation, types of Taxes, Direct Taxes, Indirect Taxes. The Unit Two gives the scope and objectives of income tax. It covers background of Income Tax, Scope of Income Tax Law, Application of Income Tax Act, 1961, Objectives of Income Tax, Taxation Structure in India. The Unit Three covers Basics of income and person. It covers the topic Concept of Income, Definition of Income, Person, Assessee, Assessment Year, Agricultural Income, Residential Status, Companies and Incomes Exempted from Tax.

So after the study of this block you will get a sufficient idea about this subject. You will not only learn the basic concepts of income tax but they will also learn the importance of this subject in this particular course.

Block Objective

After learning this block, you will be able to understand:

- Taxation and its various types.
- History and back ground of taxation.
- Objective of tax as well as income tax.
- Income.
- Assessment year and financial year.
- Agriculture Income.

Block Structure

Unit 1: Income Tax Act 1961

Unit 2: Scope and Objectives of Income Tax

Unit 3: Basics of Income and Person

UNIT 1: INCOME TAX ACT, 1961

Unit Structure

1.0 Learning Objectives

1.1 Introduction

1.2 Meaning and Definition of Taxation

1.3 Characteristics of Taxation

1.4 Types of Taxes

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1.5 Let Us Sum Up

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1.0 Learning Objectives

After learning this unit, you will be able to understand:

- State the meaning and definition of taxation.
- Enlist the characteristics of taxation.
- Enumerate the types of taxes.
- Distinguish between direct taxes and indirect taxes.

1.1 Introduction

The important aim of the economic policy is to achieve economic growth of the nation, equitable distribution of wealth and income in the country and reduction of poverty. Taking into consideration these aspects, public finance is mainly related with the methods by which the funds are raised to meet the public expenditure. To achieve this goal, public expenditure is estimated first and then an attempt is made to find out the ways and means of financing such required public expenditure. These are financed out of public revenues. Public revenues include direct taxes, indirect taxes, profit from government commercial undertakings etc. Direct and indirect taxes are important sources of raising public finance. It helps in diversification of income from the rich to the poor and from the few to the many.

The tax system in India is flexible. It helps in mobilization of resources. With this intention, the incentives for savings and investments have been provided. The direct tax system includes wealth tax, gift tax etc., apart from income tax. Taxation appears to be the most important source of revenue to the Government.

1.2 Meaning and Definition of Taxation

A tax is a compulsory payment to be made to the Government by the public. It has no relation to the benefit to be derived by the taxpayer. In other words, there is no direct return to the taxpayer for what he pays, though public in general derives a common benefit. Thus, tax is a compulsory contribution collected by the Government to meet the expenses of various public functions.

The term 'taxes' has been defined by various experts as follows:

1. **Prof. Taussig:** 'The essence of a tax, as distinguished from other charges imposed upon a person or persons by the government, is the absence of a direct quid pro quo between the taxpayer and the public authority'.
2. **P. E. Taylor:** 'A compulsory payment to government without expectation of direct return in benefit to the taxpayer is known as tax'.
3. **Prof. Bastable:** 'A tax is a compulsory contribution of the wealth of a person or body of persons for the service of public powers'.

4. **Prof. Seligman:** ‘A tax is a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without references to special benefits conferred’.
5. **Webster’s New Reverside University Dictionary:** ‘A contribution for the support of a government required of persons, groups or business within the domain of that government, i.e. taxation’.
6. **The Dictionary of Modern Economics:** Taxation means ‘Compulsory levies on private individuals and organisations made by government to raise revenue to finance expense on public goods and services and to control the volume of private expenditure in the economy’.

Check your progress 1

1. A _____ is a compulsory payment to be made to the Government by the public
 - a. tax
 - b. fine
 - c. penalty

1.3 Characteristics of Taxation

With the help of above definitions, we may deduct the following characteristics of taxation:

1. A tax is a contribution by individuals as well as organisation to the government to undertake various public activities.
2. It is a compulsory measure and the taxpayer cannot refuse to pay taxes, i.e. nobody can escape taxation; refusal to pay taxes is a crime. (Therefore, somebody rightly pointed out that there is no excuse for death and income tax.)
3. Taxes are levied to cover public expenses incurred by the government in the common public interest. Thus, money required to maintain law and order, defence, construction and up-keep of roads etc. is raised through taxes.
4. It is not possible to establish a link between the tax and its benefit to the taxpayer. Public, in general, derives the benefits of money spent by the

government but the taxpayer does not get a direct return equal to the amount of tax paid by him.

5. Paying taxes means some sacrifice by the taxpayer.
6. Taxes are levied at progressive rates.
7. It helps in diversification of income from the rich to the poor and from few to many.
8. Tax is one of the important and major sources of finance to the government.
9. Taxation results in reduction of surplus income, which was otherwise available to tax payers.
10. It may adversely affect the ability to invest.

We may conclude that a tax is compulsory and it can be imposed only by the government and none else. It is collected for the general welfare of the society and hence a taxpayer has no right to expect a direct return on the amount of tax paid by him. Benefit, thus, cannot be the basis of payment of tax by any person.

Check your progress 2

1. A _____ is a contribution by individuals as well as organisation to the government to undertake various public activities.
 - a. Interest
 - b. Tax
 - c. Penalty
 - d. fine

1.4 Types of Taxes

The economists classify taxes into two groups:

- Direct taxes
- Indirect taxes

In modern times, a different classification is available, so taxes may be grouped as under:

1. Taxes on incomes
2. Taxes on commodities
3. Taxes on capital

These three types may be regressive, proportional or progressive.

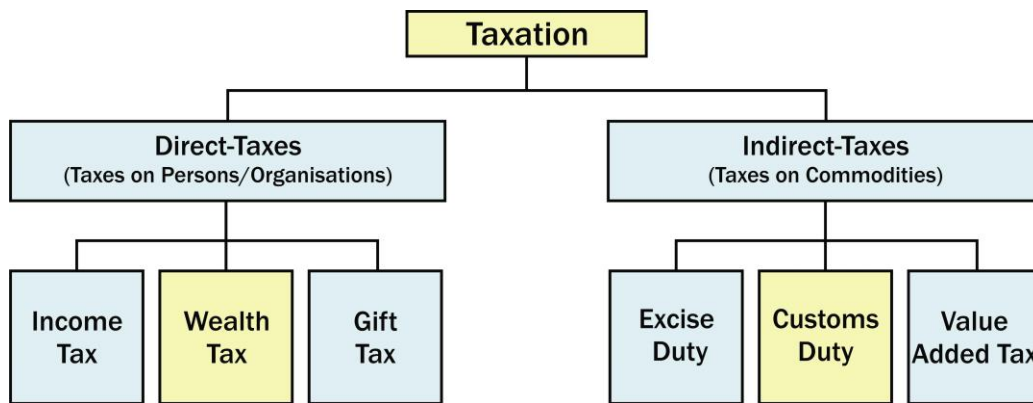


Fig 1.1 Taxation

1.4.1 Direct Taxes

Direct taxes are those taxes, which are levied immediately on incomes and property generated by the individual persons or the group of persons. The income of the person or the group of persons is directly assessed and the tax payable is determined. This tax is directly paid by the individuals to the Government treasury, thus directly contributing to the national exchequer. By this simple logic, tax on income, tax on wealth and tax on gifts are direct taxes since these are collected from persons who earn income or hold property or donate money by way of gifts. Direct taxes are normally levied on individuals, who are assessed or determined on the basis of their income or property.

Direct tax is a tax paid by a person on whom it is imposed and the burden of this tax cannot be shifted by the taxpayer to any other person. J.S. Mill has defined a direct tax as ‘one which is demanded from the very person who is intended or desired, should pay it’. In other words, where the amount of tax is paid out of the pocket of the person who is legally responsible for the payment of the tax is termed as ‘Direct tax’.

Advantages of direct taxes

Following are the advantages of direct taxes:

1. **Direct tax system helps to create general consciousness in the society:**
As the tax payer knows how much money he is required to pay and how much money he has paid towards tax on income or property, the direct-tax system helps to create general consciousness and awareness in the society. Due to this characteristic of the direct tax system, it is regarded as the simplest and most effective method of revenue realization.

2. **Revenue elasticity:** The revenue of direct taxes varies according to the change in the income. As the income increases, the tax collection also increases. The rates of direct taxes are generally progressive, i.e. lower rate of tax at lower level of income and higher rates of tax at higher level of income. The rates go on increasing with the level of income. Due to this progressive system of tax rates, the revenue from tax collection increases faster than the increase in the income.
3. **Most logical and rational revenue mobilization method:** As the rates of direct taxes are progressive they are directly related to the capacity of the tax payer to bear the burden of tax. The lower amount of taxes is levied on the persons earning lower income while the persons earning more income are required to pay higher taxes. Due to this, lower burden is placed on the weaker section of the community whereas the economically stronger class of the society has to bear larger share of tax collection.
4. **Reduce the inequality between the rich and poor:** The direct taxes are also used as one of the measures to reduce the inequality between the rich and the poor by taking away more and more money from the rich by way of higher taxes on income and property and distributing that income among the poor class of the society through various schemes and provisions of amenities. The higher incidence of taxes on income and properties of rich persons reduces the consumable surplus a variable with them, which otherwise would have been spent by them on non-priority items. This surplus taken away from rich class is utilized in implementing the socio-economic welfare schemes for the benefit of the poor class of the society.
5. **More realistic estimates can be possible:** As the direct taxes are directly assessed and determined with reference to the income generated in the society, its estimation and budgeting at the planning stage becomes very easy. More realistic estimates can be made as compared to other tax collection system, which helps the Government authorities in making fiscal economic policies.

Disadvantages of direct taxes

Following are the disadvantages of direct taxes:

1. **Difficult and time-consuming tax collection process:** Due to large number of tax payers spread over at different levels of income in the country, the assessment of tax becomes cumbersome procedure. To determine the tax

liability, the detailed scrutiny of the accounts and financial affairs of the tax payer is essential but for which the possibility of evasion of tax increases.

2. **Cost of collection is exorbitantly high:** As the Government expenditure on running the big collection machinery, which includes thousands of employees at various levels, maintenance of office establishments across the country etc. is day by day increasing. Therefore, the revenue from direct taxes becomes less beneficial. Sometimes, even the total abolition of the direct taxes is also advocated by economists and financial experts as according to them the revenue realization from direct taxes is meager as compared to this tremendous cost of collection.
3. **Pinch the tax payers more:** Direct taxes are to be paid in lump sum and hence, pinch the tax payers more.
4. **Many people find it difficult to understand:** The laws of direct taxes have become so complicated that many people find it difficult to understand. This requires the expert assistance of tax advisor.
5. **Lead to the tendency to avoid the work:** The major portion of the income, particularly at the higher levels of income, being taken away by the Government by way of taxes, the desire to work hard and earn more and more income gets reduced. This may also adversely affect the overall production in the country.
6. **Evasion and corruption:** As the direct taxes are assessed on the individual persons, the honest persons are charged tax strictly as per legislation whereas the dishonest tax payers escape out of their tax liability by maneuvering their affairs in such a manner so as to reduce their tax liability. There is a great scope for tax evasion by concealing real income. It may be found in direct system that "Honesty is taxed while dishonesty is rewarded". It leads to corruption.
7. **Arbitrarily decided:** The nature and base of direct taxes are arbitrarily decided. The finance minister uses his own judgements in determining the taxation potential of the tax payer. There is no scientific formula for evolving the mode of gradation and progression in direct taxation.
8. **Narrow-based calculation of tax:** Direct taxes are narrow based as many concessions are given to low income groups. The poor section of the society remains untouched under direct taxes and to that extent they fail to achieve their objectives of promoting civil sense among all the citizens.

1.4.2 Indirect Taxes

An Indirect tax is a tax, the burden of which can be shifted to others.

The indirect taxes are levied on commodities at the stage of manufacture, sale or import. Both direct and indirect taxes aim at the same objective, i.e. to raise the revenue and at the same time to control the expenditure and investment. However, their mode of collection is different, depending upon the various factors.

The indirect taxes are collected at the consumption stages and at the time of spending the income, as the indirect taxes are mainly levied on the commodities, they are collected at the time of sale or purchase of the commodities in the commercial activity of business. The indirect taxes are collected at various stages in the chain of manufacture from raw materials to the consumption of finished goods. The customs duty is levied at the time of import of goods into the territory of the country. The excise duty is collected at the time of production of finished products and it is levied on the person who manufactures the finished products. The Value Added Tax is collected from the seller of the finished products when he sells the product in the commercial market. The incidence of these taxes is passed on by the manufacturer or seller to the ultimate consumer, commonly called as the customer, through the price charged for the commodity sold. Thus, incidence of indirect taxes gets shifted to the individual person in the society, although they are not directly paid by him into Government treasury.

When the liability of a tax is on one person but the burden of it falls on another person, it is an indirect tax. It is a tax the impact of which falls upon one person who can shift the money burden of the tax on some other person. Thus, impact and incidence of indirect tax are on different persons. Consequently, a tax payer is not the tax bearer. For example, taxes on commodities (such as Excise Duty, Value Added Tax (VAT), Import Duty) are imposed upon the producers, dealers or importers, as the case may be, but the burden thereof falls on the consumers.

Advantages of indirect taxes

Following are the advantages of indirect taxes:

1. **Convenience in collection and assessment:** The major advantage of indirect taxes is its convenience in collection and assessment. As the indirect taxes are collected at various stages in the commercial activity, those are relatively simple to realize and their realization automatically increases with the increase in the commercial activity. Excise duty is collected at the time

of delivery of the manufactured goods from the factory, whereas Value Added Tax (VAT) is collected at the time of sale of such manufactured goods in the market. The customs duty is levied at the time of import of the goods into the country. Since the indirect taxes are normally levied on organized sector, its realization becomes simple and very convenient.

2. **Pinch the tax payers less:** It pinches the tax payer less as he is kept in the dark about how much tax he has paid on his total purchases.
3. **Indirect taxes are difficult to evade:** Evasion of taxes is possible only when manufacturers manipulate the accounts, importers smuggle the goods etc. Otherwise it is very difficult to evade.
4. **Broad-based calculation of tax:** Indirect taxes have a broader scope than direct taxes. The low income groups of society which are exempted from direct taxes can be easily caught in the net of taxation through indirect taxes. Thus, indirect taxes may be considered as a balancing factor in the equity of a tax policy. Indirect taxes cover almost the entire population of the country.
5. **Indirect taxes can be used to protect the health of the society:** The indirect taxes also play the important role of social service to the community by discouraging the consumption of undesired articles such as tobacco, cigarettes, liquors and narcotics drugs by making them costlier by imposition of heavy taxes. This can be said as one of the social benefits of the taxation policy that the Government can achieve.
6. **Progressive tax policy:** The indirect taxes are generally levied on an ad valorem basis i.e. on the basis of value of the commodities. The rates of taxes are also different for different commodities, higher for luxury items like refrigerators, cars, air conditioners etc. and lower for necessity items like edibles, drugs, basic raw materials etc. The revenue from such taxes can be increased based on pattern of demand for the commodities.
7. **Indirect taxes can serve as complementary to direct taxes:** Additional revenue can be easily obtained by introducing indirect tax rather than a direct tax, without revealing its real burden to the public.
8. **An effective means of mopping up consumer's surplus:** Indirect taxes are an effective means of mopping up consumer's surplus which can be utilized fruitfully in expending the process of capital formation in the country.

Disadvantages of indirect taxes:

Following are the demerits of indirect taxes:

1. **Indirect taxes do not createsocial consciousness:** The indirect taxes do not create the social consciousness and awareness as the person paying the taxes, in most of the cases, even does not realize or feel the incidence of tax.
2. **Difficult to assess the effect of the incidence of taxes:** As it is very difficult to assess the effect of the incidence of taxes on the demand of commodities, the estimates of revenue from indirect taxes may go wrong. This is more possible, in case of commodities with elastic demands since the demand of such commodities, will be adversely affected by increase in taxes and the desired level of revenue may not be achieved.
3. **They are not levied according to the principle of ability to pay:** Indirect taxes are charged at a proportional rate on commodities of general consumption, their burden falls more heavily upon the poor section of the people.
4. **Uneconomical:** Indirect taxes do not comply with the principle of economy and productivity. As these taxes involve many stages, the cost of collection is usually high in relation to the revenue yielded.
5. **Proved to be inflationary:** Indirect taxes prove to be inflationary as they increase the prices of commodities by the amount of tax levied

Although the attempt of comparison and distinction between direct and indirect taxes is made, based on their merits and demerits the two systems are mutually complimentary to each other. Both the systems have the same objective to meet i.e. the redistribution of income in the society and raising revenue by such redistribution of income. Only the process of achieving such objective is different.

Distinction between direct and indirect tax:

The following table indicates the difference between direct and indirect taxes.

Point of Distinction	Direct Taxes	Indirect Taxes
1. Nature of tax	It is a tax on Person.	It is a tax on Commodity.
2. Who pays the tax	A 'Person' pays the tax.	A 'dealer' pays the tax.

3. Burden of tax	Person paying the tax has to bear the burden.	Person paying the tax does not bear the burden,
4. Shifting the burden of tax	The burden of tax cannot be shifted by the taxpayer.	The burden of the tax is shifted to some other person.
5. Return of tax collected	The question of giving something in return of the tax collected does not arise. However, tax proceeds are utilized for public purposes.	The question of giving something in return of the tax collected does not arise. However, tax proceeds are utilized for public purposes.
6. Base of assessment	The taxes which are based on income or receipts are called direct taxes.	The taxes which are levied on expenditure are called indirect taxes.
7. Examples	Income tax, wealth tax, Gift tax etc., are treated as direct taxes.	The taxes on commodities such as Excise Duty, Custom Duty, Value Added Tax (VAT) etc., are treated as indirect taxes.
8. Process of achievement	The process of achievement takes place through the correlation of ability to pay and the actual tax payment.	The process of achievement takes place through commodity market.
9. Pinching	Direct taxes are to be paid in a lump sum and hence pinch the tax payer more.	It pinches the tax payer less as he is kept in dark about how much tax he has paid on purchases.
10. Inflation	Direct taxes are considered as an effective and important tool of anti-inflationary fiscal policy.	Indirect taxes prove to be inflationary as they increase the prices of commodities by the amount of tax levied.

Check your progress 3

1. _____ tax is a tax paid by a person on whom it is imposed and the burden of this tax cannot be shifted by the taxpayer to any other person.
 - a. Direct
 - b. Indirect
 - c. income

1.5 Let Us Sum Up

In this block we have studied that for the development of any economy funds are required and in this taxation play a major role. Through taxation money is collected from the general public which is utilised for the development of the economy and society.

The important aim of the economic policy is to achieve economic growth of the nation, equitable distribution of wealth and income in the country and reduction of poverty. Taking into consideration this aspect, public finance is mainly related with the methods by which the funds are raised to meet the public expenditure. To achieve this goal public expenditure is estimated first and the attempt is made to find out the ways and means of financing such required public expenditure. These are financed out of public revenues. Public revenue includes direct taxes, indirect taxes, profit from government commercial undertakings etc. Direct and indirect taxes are one of the important sources of raising public finance. It helps in diversification of income from the rich to the poor and from the few to the many. A tax is a compulsory payment to be made to the Government by the public. It has no relation to the benefit to be derived by the taxpayer. In other words, there is no direct return to the taxpayer for what he pays, though public in general derives a common benefit. Thus, tax is a compulsory contribution collected by the Government to meet the expenses of various public functions.

Therefore in this unit we have discussed the role of and importance of taxation in our economy. This brief will certainly help the students in getting the sufficient information required for this curriculum.

1.6 Answer for Check Your Progress

Check your progress 1

Answers: (1-a)

Check your progress 2

Answers: (1-b)

Check your progress 3

Answers: (1-a)

1.7 Glossary

1. **Direct Tax** - Direct taxes are taxes imposed on income, capital gains and net worth. Gift tax, death duties and property tax are also considered direct taxes.
2. **Indirect Tax** -Tax imposed on certain transactions, goods or events. Examples include VAT, sales tax, excise duties, stamp duty, services tax, and registration duty and transaction tax.

1.8 Assignment

Write in detail about indirect tax and give examples.

1.9 Activities

Explain direct taxation with examples

1.10 Case Study

Make a list of the direct taxes and indirect taxes and discuss it with your group.

1.11 Further Readings

1. Direct Taxes, Gupta and Ahuja.
2. The Economics of Taxation, Bernard Salanié, MIT Press, 1997.
3. The Economics of Taxation, Henry Aaron and Michael J. Boskin, the Brookings Institution, 1980.
4. Taxation: Its Principles and Methods, Luigi Cossa.

UNIT 2: SCOPE AND OBJECTIVE OF INCOME TAX

Unit Structure

- 2.0 Learning Objectives**
- 2.1 Introduction**
- 2.2 Background of Income Tax**
- 2.3 Scope of Income Tax Law**
- 2.4 Application of Income Tax Act, 1961**
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- 2.6 Taxation Structure in India**
- 2.7 Let Us Sum Up**
- 2.8 Answers for Check Your Progress**
- 2.9 Glossary**
- 2.10 Assignment**
- 2.11 Activities**
- 2.12 Case Study**
- 2.13 Further Readings**

2.0 Learning Objectives

After learning this unit, you will be able to understand:

- Explain the background of Income Tax.
- Specify the scope of Income Tax Law.
- Discuss the scheme of sections and sub sections in the Income Tax Act.
- Enumerate the objectives of Income Tax.
- Justify the model of three tier government policies.
- Elaborate on the model of the taxation structure in India.
- State the observations of Indian tax structure.

2.1 Introduction

One of the major sources of Government revenue is 'taxation'. The economic definition of the term 'tax' can be described as "a tax is a mandatory contribution from the citizens of the nation to the expenditure incurred by the Government to achieve common interest of the citizens without reference to specific benefits conferred on any individual". In other words, it is nothing but the share of the person paying tax, in the joint liability of the nation for its growth and development. In the country like India where the needs of development are constantly increasing the taxation and its policy assumes greater importance in resource mobilization.

2.2 Background of Income Tax

Apart from catering the need of development finance, the taxation policies are also used as a tool for reducing the inequality in incomes, proper distribution of national income into various classes of society, checking the inflationary trends in the economy and for attaining other socio-economic goals of the nation.

The Government of India provides for the division of tax powers between the Centre and the States. The Centre is allocated exclusive jurisdiction over the following taxes:

1. Income-tax
2. Wealth-tax
3. Gift-tax
4. Exciseduty
5. Customs duty

In accordance with the power conferred by the Constitution, the Income-tax Act has been enacted. The present Income-tax Act (1961) is a comprehensive legislation containing various provisions on every aspect of income-tax. It replaced the old Indian Income-tax Act, 1922 which had been in force for four decades. The new Act after it came into force, was amended several times to make it simpler and at the same time to make it more productive. The Central Government through its fiscal policies of budgetary planning tried to make the income-tax more effective by inducing new incentives and new tax policies.

Check your progress 1

1. The Government of India provides for the division of tax powers between the _____
 - a. Centre and the states
 - b. People and states
 - c. States

2.3 Scope of Income Tax Law

The law of Income Tax is contained in Income Tax Act, 1961. Major amendments have been made in the finance bill 2001 and the latest finance bill is of year 2015. (As passed by parliament).

The Income Tax Act broadly covers the following:

1. Basis of charging income
2. Incomes exempt from Income Tax
3. Computation of incomes under various heads
4. Clubbing of income
5. Set off any carry forward of losses
6. Permissible deductions
7. Rebates and reliefs
8. Double taxation relief
9. Determination of tax in certain special cases
10. Non-residents (special provisions)
11. Tax on dividends distributed by domestic companies
12. Income tax authorities and their powers
13. Survey, search and seizure
14. Assessment procedure
15. Assessment of firms
16. Collection and recovery of Tax - TDS
17. Payment of advance tax

18. Refund
19. Advance rulings
20. Appeal and revision
21. Acquisition of immovable property
22. Penalty
23. Prosecution

For implementing the various provisions of the Act, Income Tax Rules, 1961 have been framed which prescribe the procedures, time-limits, conditions, returns, forms etc. Besides, the Central Board of direct Taxes has issued a number of circulars/ notifications, clarifying the provisions of the Act, either on its own initiative or at the instance of public queries.

Check your progress 2

1. Latest finance bill is passed in which year _____
 - a. 2014
 - b. 2015
 - c. 2000
 - d. 2005

2.4 Application of Income Tax Act, 1961

The Income-Tax Act, 1961 is applicable to whole of India including States and Union Territories. It brings the charge of income-tax on the income arising or accruing in the whole of India. The Income-Tax Act levies the tax on 'income'. The term 'income' used in the Act has a much wider connotation as it includes different types of receipts or gains which normally would not have been treated as 'income'. The Section-2 (24) of the Act provides an inclusive definition of the term income which enlarges the scope of the levy of income-tax on all possible incomes. There is no comprehensive definition of the term income in the Act; thus covering into its ambit different types of the income by its inclusive nature.

The various types of incomes liable to income-tax under the Income-tax Act, 1961 have been classified under different heads of income as under: (Heads of Income: U/S14).

1. Income from Salaries

2. Capital gains
3. Profits and gains from business or profession
4. Income from house property
5. Income from other sources

The scheme of the section and sub-sections in the Act provides the method and conditions for computation of taxable income liable to income tax.

Section-2 of the Act provides the definitions of various expressions used in the Act. For example, sub-section (24) defines what income is, sub-section (1) defines what agricultural income is. The expressions 'assessee' and 'person' have been defined in the sub-section (7) and (31) respectively. These definitions provided in Section 2 of the Act define the scope of the Act and its applicability to different types of income or different types of persons.

Section-3 of the act defines the expression 'Previous Year' which is nothing but a financial year immediately preceding the assessment year. The assessment year commences from 1st April and ends on 31st March. The assessment of income-tax is made with reference to the financial year relevant to the assessment year.

Section-4 of the Act is a charging section. Accordingly, the income-tax is charged on the income assessed for the previous year at the rates specified in the schedule contained in the Finance Act. Every year the Parliament passes the Finance Act in the budgetary sessions which provides the rates of income-tax to be applied for ensuing financial year.

Section-5 of the Act specifies the scope of the total income liable to the income-tax in any previous year. It provides the conditions for taxability of income based on its accrual or receipt in India or outside India.

Section-6 of the Act provides the rules for determination of the residential status of the different classes of assesses based on which the tax liability under the Act is computed.

Section-10 of the Act provides a complete list of all the incomes that are totally exempt from tax, if a person is in receipt of such income he is not required to pay tax thereon

Check your progress 3

- 1. There are _____ major heads of income under income tax act
 - a. Five
 - b. Sixd. twenty
 - c. Ten

2.5 Objectives of Income Tax

Tax revenue is treated as one of the most important way of raising the funds for government activities. Apart from rising of funds, the tax policies are being framed to achieve several economic and social objectives.

The objectives of the ‘Income Tax’ in India may be summarised into following broad headings



Fig 2.1 Objectives of income tax

1. The equity objective-

This takes into consideration the ability to pay. This implies that everybody should be taxed according to the income he earns. Equity and social justice demands that the rich people should bear a heavier burden of tax and the poor a lesser burden. This has been well achieved as the Income Tax in India is highly progressive. As the income increases the burden of tax also increases.

Due to this progressive burden of tax the extra income accumulated with the rich class of the society is taken away by way of income-tax and it is diverted to the necessary development schemes for the benefits of the poor class of the society, thus uplifting the economic level of the mass community. This assists in reducing the gap between rich and poor by curtailing the consumable surplus available in the hands of the rich. This re-distribution of income is one of the most important roles played by the income-tax in India.

2. Revenue mobilization objective-

The scope of rising of funds from income tax is limited. But tax policies adopted in our country are useful in mobilizing the resources. The government is using income-tax as one of the device to mobilise the resources. In spite of progressive rates of income-tax the revenue realized through income-tax is not significant because very few citizens are charged to income-tax, by a rough estimate even less than five percent of the total population is contributing to the tax realization. Due to this the share of income tax in the total Government Revenue is less than ten percent of the total revenue. The income tax did have a prominent role in revenue mobilization in the past, but over the five year plans its significance has gradually decreased.

3. The growth objective-

Direct tax like income tax is being used as an important instrument of economic growth. It is aimed to accelerate economic development. For this purpose, tax policies are framed in such manner that undesired expenditure is restricted and savings is increased.

By employing the proper personal tax and corporate tax policies, the investment in capital formation is encouraged. Different rebates and concessions are provided in the Act to induce more and more investment in priority sectors of the economy which in turn generates more income in those sectors. The allowance of depreciation and investment deposits provided in the Income-tax Act are primarily meant for augmenting the capital base of the country. The income-tax deductions provided on account of savings in the long term investments like

Provident Funds, L.I.C. policies, Public Provident Funds, Savings Certificates etc., are used to divert the money from undesired expenditure to productive sector.

4. The stabilizations objective-

The tax rate structure existing in India is at highly progressive rates. Therefore, if national income rises, the tax revenue will rise automatically and if national income falls, the tax revenue will decrease automatically. This helps in achieving the economic stability.

However, the following other objectives may be stated

1. To promote certain types of business-activities. For example, recently tourism is being encouraged on a wider scale. For this purpose, the Income Tax Act provides for certain tax concession in respect of earnings in convertible foreign exchange from hotel business or travel agency. Similarly, export promotion ranks priority in India. The Act provides for deduction in respect of profits from exports. To add, the Government has been trying to reduce regional imbalance and encourage development of backward areas. In such a case, the Act provides for deduction in respect of profits from newly established industrial undertaking or hotel business in backward areas in respect of profits from newly established small scale industrial units in rural areas.
2. To create proper investment climate, the income tax legislation encourages savings and investments.

To stimulate and stabilize economic growth and to help in solving even specific problems.(Recently the earthquake problem faced by the Gujarat State.)

Check your progress 4

1. _____like income tax is being used as an important instrument of economic growth and development
 - a. Indirect tax
 - b. Direct tax

2.6 Taxation Structure in India

In the development of India, particularly after independence, the taxation has played a significant role. In the socialistic economic pattern adopted by our country where the fiscal policies are used as the tool for development and growth the taxation has been treated as the most important source of revenue. The various five year plans were implemented for attaining the socio-economic goal of the country. The expenditure planned for the development was mainly financed by raising tax revenue by adopting different types of taxation policies. As can be commonly seen in any developing economy, in India also to be greatest need of the economy is to break the vicious circle of poverty, low level of savings, low level of production and the alarming unemployment. The Indian Government through its fiscal measures has played a vital role in overcoming these basic problems. The taxation structure adopted in our country is mainly based on two types of taxes, i.e. Direct taxes and Indirect taxes.

Three Tier Government Policies:

India has a three-tier Government.

- The Central Government
- The State Government
- The Local Government

The Local Governments are directly under the State Government and hence no separate allocation of taxation rights has been done to them. To avoid any conflict or dispute between the Centre and the States in the matter of taxation, the following provisions are included in our Constitution:

- There is no tax, which can be levied by-both the Central and the State Governments. Thus, customs and corporation tax are levied by the Central Government. These two taxes account for about 50 per cent of its tax receipts.
- States have powers to levy some other taxes and the tax collection may be utilized on their activities.
- Some taxes are levied and collected by the Central Government but their proceeds are shared by the centre and the states, e.g., Income tax and Union excise duties are the examples of this category. The Finance Commission advises, from time to time, on the basis of division between the Centre and the States.

- In some cases, power to levy and collect taxes is vested with the Central Government but the tax proceeds are to be distributed among the States. Duty on railway freight and fares, terminal tax on goods and passengers carried by railways etc. taxes on sale/purchase of newspapers and on advertisement in the newspaper are the examples.
- Some taxes are levied by the Central Government but the responsibility to collect them rests on the State Government, e.g. stamp duties (except those included in the Union list) and excise duties on drugs and cosmetics are the taxes belonging to this category.

According to the above guidelines, direct taxes are collected by the Central Government. Income-tax (being one of the direct taxes) is levied and collected by the Central Government, but the proceeds thereof are shared by the Centre and States on the basis of division advised by the Finance Commission from time to time. Besides Income Tax, Wealth Tax, Gift Tax, Estate Duty (discontinued from 16th March, 1985), the Companies (Profit) surtax (discontinued from 1st April, 1988), Expenditure tax, Corporation tax, Service tax are the direct taxes that are levied and collected by the Central Government.

Model of the taxation structure in India:

To understand the taxation structure in India, one has to study the different taxes imposed on the citizens through various enactments and legislations. The simple model of the taxation structure in India is depicted in the following table.

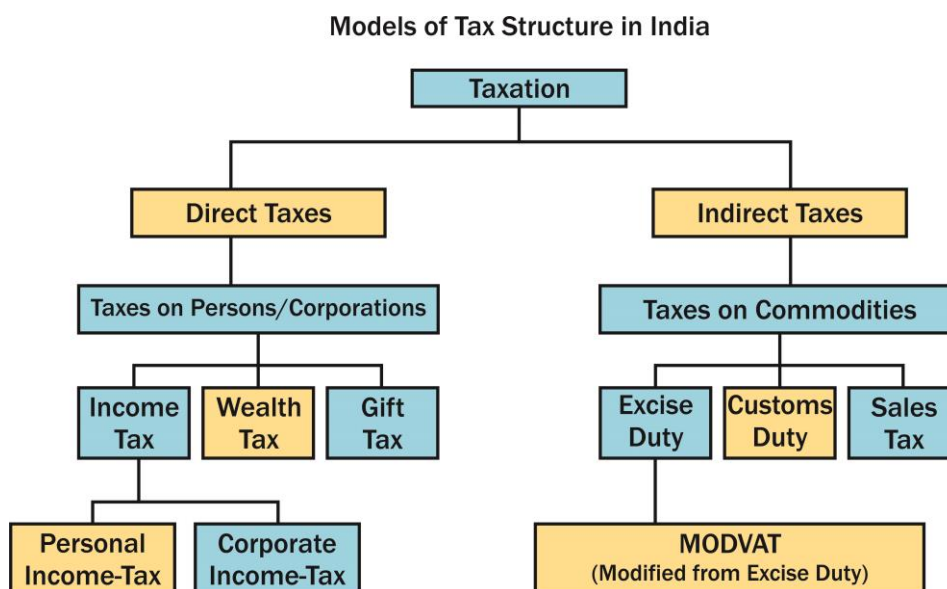


Fig 2.2 Models of Tax structure in India Taxation

1. Direct Taxes

- a. **Income tax:** The income-tax is levied on the income of different category of persons as per the provisions of Income-tax Act, 1961. Various rates and provisions are made under this Act, to enable the assessing authorities to compute the taxable income.

Different types of exemptions and concessions are also given in the Act. After computing the taxable income as per the various provisions of the Income-tax Act, 1961, the rates of income-tax applicable to that assessment year is applied to find out the tax liability. As laid down in the Income-tax Act, the applicable rates are prescribed by the Finance Act of that year. The Finance Act is normally presented by the Finance Minister before the Parliament in the form popularly known as 'Budget' every year. The collection of income-tax is mainly through personal income-tax and corporate income-tax, the share of corporate tax being the largest one.

The rates of income-tax are progressive and incidence increases with the rise in income. The basic limit of total exemption is fixed and the income crossing the basic limit is subjected to tax.

Certain provisions are included in the Income-tax Act making it compulsory to deduct the tax at source of the income itself and to pay it to the Government treasury. These provisions in the Act ensure the better collection of tax.

- b. **Wealth-tax:** The wealth-tax as the name suggests, is the tax on wealth or property held by the tax payer. The quantum of wealth accumulated over and above the basic exemption limit is subjected to wealth-tax. The present limit for exemption from wealth-tax is Rs. 15, 00,000. The provisions for charging the wealth to wealth-tax and various exemptions and deductions are contained in the Wealth-tax Act, 1959. The various types of assets like jewellery, gold, ornaments, buildings, cash and bank balances, investment in company shares and debentures etc., accumulated by the assessee are liable to tax under this Act. Although the revenue from the wealth-tax is not significant in the total Government revenue, the tax on wealth basically serves the social purpose of redistribution of wealth in the society. By imposing the wealth-tax, some of the wealth accumulated by the rich is taken away; thus, attempt is made to reduce the gap between the rich and the poor.

- c. **Gift-tax:** -The Gift-tax Act, 1958 was introduced mainly to discourage the avoidance of income and wealth-tax by transferring the sources of income to another person. Subject to basic exemption limit, the amounts gifted by the assesseees to other persons are liable to gift-tax, under the various provisions contained in the Gift-tax Act. Although the share of gift-tax in the total Government revenue is also insignificant it's main objective is to check the illegitimate transfer of income to other persons with a view to avoid taxes. **Section-5** (1) of the Gift tax Act enumerates the various types of gifts which are exempt from Gift Tax.

The tax system in India is flexible. It helps in mobilization of resources. The direct tax system includes above mentioned wealth tax, gift-tax etc. apart from income tax. Due to low level of national income, agricultural income exempted from tax, high level of unemployment etc., the scope of direct taxes is very limited and the need of indirect taxes has become more and more important to raise the revenue to meet the development expenditure.

2. Indirect Taxes

Customs and Central excise are important sources of Central Government revenue. These account for about 80 per cent of total revenue. Taxation measures undertaken during the recent years intended to achieve reforms in the structure of customs and excise duties and are designed to further promote the basic objectives of economic growth, equity, simplicity and revenue raising capacity.

- a. **Excise Duty:** The excise duty is a tax on manufacture. The commodities produced at the manufacturing premises are subjected to excise duty. The various provisions for charging the excise duty on different manufactured products are enacted through a very 'comprehensive legislation called as Central Excises and Salt Act, 1944. Different commodities are classified into various tariff headings under the provisions of the Central Excise Tariff Act of India, 1985 and the rates of excise duty .for each such tariff classification is also prescribed under the same Act.

The levy of excise duty is based on two-tier system:

- Basic Excise duty
- Special Excise duty

The Act also provides various exemptions and concessions taking into consideration need for economic development of the country, at the same time social goals of the society. The effective Government machinery for collection of excise duty is formulated under the Act itself and its implementation is also governed by the same Act.

- b. Customs Duty:** The Customs Act of India was enacted to impose the custom duty on the goods imported in India. Different commodities are classified into various customs tariffs as per international Harmonious System of Nomenclature (HSN) and the rates of customs duty are prescribed for each such tariff entry. The levy of customs duty is based on three-tier system i.e. Basic customs duty, Auxiliary customs duty and countervailing customs duty. The policies of imposition of customs duty and various exemptions are made after giving 'due consideration to the availability of foreign exchange resources, need to protect indigenous industries by discouraging the use of imported goods, development of indigenous industries etc.

Observations on Indian Tax Structure:

From the Indian Tax structure reviewed above, we may make certain observations on Indian tax structure. They are mentioned below:

1. Tax revenue has provided a major part of the Government's needs for meeting its expenditures, covering development and non-development expenses. Tax revenue has been a much bigger source of govt. finance as compared to other sources like deficit financing, all types of borrowings etc. This source accounts for about 50 percent of the total government spending.
2. Direct taxes play a significant role in tax system not only as a revenue source but as a powerful instrument for achieving social and economic objectives. First of all, direct taxes help to make tax system progressive and reduce disparities in distribution of income and wealth. Secondly, they help the strategy of planning in many ways. Various rules and regulations in tax laws are encouraging to promote savings. In India, Income tax and also taxes on capital are designed to serve these objectives.
3. Indirect taxes accounted for a large share in the revenue right from 1951 and till recently it was as much as about 80% of total tax revenue.

4. Revenue from taxes has recently been showing a rising trend, though this rise has not been in proportion to the national income. Taxes have been indicating a continuous rise in Government income.
5. The prevention of inflationary price increase was ascribed a priority position in India through its planning process. Like in any developing country, in India also the problem of inflationary trend setting in the economy has been causing the great worry to the Government. This is mainly because, in the initial stages of development projects, a large amount of income gets generated without the adequate supporting back up of corresponding production of commodities. This results into changing pressure on demands of the commodities without sufficient availability of the production.
6. India basically being the poor country, having very low per capita income, the scope of income-tax has been very limited. In our country very few people are in the tax brackets due to the heavy dependence on the agriculture and at the same time the large scale unemployment prevailing in the country. The agricultural income, as a policy has always been outside the tax bracket, thus restricting the scope of income-tax in revenue realization.

Recent unofficial estimate indicates that actual tax evasion is, in some cases, nearly 75 per cent of the actual tax liability. This has resulted in the emergence of 'parallel economy' (black money) and this result in a continuous loss of revenue to the Government. It is, therefore, necessary to control tax evasion. For this purpose, the Government has taken various legislative and administrative steps

Check your progress 5

1. India has a _____ tier Government
 - a. Two
 - b. Three
 - c. Four
 - d. five

2.5 Let Us Sum Up

In this block we have discussed few more things about taxation .One of the major sources of Government revenue is ‘taxation’.

The economic definition of the term ‘tax’ can be described as “a tax is a mandatory contribution from the citizens of the nation to the expenditure incurred by the Government to achieve common interest of the citizens without reference to specific benefits conferred on any individual”. In other words, it is nothing but the share of the person paying tax in the joint liability of the nation for its growth and development. Apart from catering the need of development finance, the taxation policies are also used as a tool for reducing the inequality in incomes, proper distribution of national income into various classes of society, checking the inflationary trends in the economy and for attaining other socio-economic goals of the nation.The Government of India provides for the division of tax powers between the Centre and the States.

In the development of India, particularly after independence, the taxation has played a significant role. In the socialistic economic pattern adopted by our country where the fiscal policies are used as the tool for development and growth the taxation has been treated as the most important source of revenue. As can be commonly seen in any developing economy, in Indiaalso tube greatest need of the economy is to break the vicious circle of poverty, low level of savings, low level of production and the alarming unemployment. The Indian Government through its fiscal measures has played a vital role in overcoming these basic problems. The taxation structure adopted in our country is mainly based on two types of taxes, i.e. Direct taxes and Indirect taxes. This unit thus is going to be of great help to the readers in understanding the concept behind the introduction of taxation not only in India but all over the world.

2.6 Answer for Check Your Progress

Check your progress 1

Answers: (1-a)

Check your progress 2

Answers: (1-b)

Check your progress 3

Answers: (1-a)

Check your progress 4

Answers: (1-b)

Check your progress 5

Answers: (1-b)

2.7 Glossary

1. **Distribution** - A payout of cash or property from a corporation to a shareholder.
2. **Dividends** - A payment by a corporation to shareholders, which is taxable income of shareholders. Most corporations receive no deduction for it.

2.8 Assignment

Give a detailed account of Indian Tax structure.

2.9 Activities

Describe the scope and objectives of Income Tax.

2.10 Case Study

Prepare a detailed note on the application of Income Tax Act with suitable examples. For the preparation of list take help from the internet.

2.11 Further Readings

1. Direct Taxes, Gupta and Aujha
2. The Economics of Taxation, Bernard Salanié, MIT Press, 1997

UNIT 3: BASICS OF INCOME AND PERSON

Unit Structure

3.0 Learning Objectives

3.1 Introduction

3.2 Concept of Income

3.3 Definition of Income

3.4 Person

3.4.1 Individual

3.4.2 Hindu Undivided Family

3.4.3 Company

3.4.4 Firm

3.4.5 Association of Persons and Body of Individuals, Associations of Persons, whether Incorporates or not

3.4.6 Body of Individuals

3.4.7 Local Authority

3.4.8 Artificial Judicial Persons

3.5 Assessee

3.6 Assessment Year

3.7 Agricultural Income

3.8 Residential Status

3.9 Companies

3.10 Incomes Exempted from Tax

3.11 Let Us Sum Up

3.12 Answer for Check Your Progress

3.13 Glossary

3.14 Assignment

3.15 Activities

3.16 Case Study

3.17 Further Readings

3.0 Learning Objectives

After learning this unit, you will be able to understand:

- Explain the concept of income
- Define income
- Specify the tests of governing the concept of income
- Discuss the concept of Assessment Year
- Elaborate on agricultural income
- Describe the incomes exempted from Tax

3.1 Introduction

Income-tax as the word implies is a tax on “income”. Therefore, one has to know as to what is income which is chargeable to income-tax. In general, the term income means any monetary gain either in the form of money or money’s worth coming from a certain source with some sort of regularity. Income is the return on capital but capital is not necessarily a source of income in all cases. The term ‘income’ is of such a wide importance that it is very difficult, perhaps impossible, to define precisely. In a leading case, Kamakhya Narayan Singh V/s. Commissioner of Income Tax, the learned judges have remarked, ‘... the word income’ is of the broadest connotation, it is a word difficult and perhaps impossible to define’.

3.2 Concept of Income

The Indian Income Tax Act does not provide any definition of the term ‘income’. It only gives a list of sources of income and prescribes methods of computation of income under various heads of income, (e.g. Income from salary, house property, business etc.). The Act specifies the items which are included in income and, thus, items which do not appear in the list escape the tax net. The Act tried to make the concept of income as broad as possible. Hence, income includes salaries, income from house property, profits and gains from business/profession,

capital gains etc. A Various section of the Act makes the concept of income an 'all inclusive' and does not spare income from any source from being taxed

Check your progress 1

1. The Indian Income Tax Act does not provide any definition of the term _____.
- | | |
|-------------|------------|
| a. Income | c. Money |
| b. Interest | d. Assesse |

3.3 Definition of Income

The definition provided under Sec. 2(24) enumerates certain items, some of which cannot ordinarily be considered as income, but are statutorily to be treated as such. The definition of the word income as provided in the Section 2(24) is reproduced below: Income includes:

1. Profits and gains
2. Dividend
3. Voluntary contribution received by
 - a. Trust created wholly or partly for charitable or religious purposes or
 - b. An institution established wholly or partly for such purposes or
 - c. Scientific research association or
 - d. Games or sports association or
 - e. Any institution or fund established for charitable or religious purposes
4. The value of any perquisite or profit in lieu of salary taxable under Section 17(2) and Section 17(3)
5. Any special allowance or benefit specially granted to an assessee to meet his expenses wholly, necessarily and exclusively for the performance of duties
6. Any allowance granted to the assessee either to meet his personal expenses at the place where he performs his duties or to compensate him for the increased cost of living

7. The value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by a person who has substantial interest in the company or by a relative of the director or such person and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid
8. The value of any benefit or perquisite obtained by any representative assessee or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee
9. Any sum chargeable to income tax under Section 28 or 41 or under Section 59
10. Profits on sale of a licence granted under the imports (control) order, 1955
11. Cash assistance received or receivable by any person against export under any scheme of the Government of India
12. Any duty of customs or excise repaid or repayable as drawback to any person against exports under the customs and Central Excise Duties Drawback Rules, 1971
13. Any capital gains chargeable under Section 45
14. The profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society computed in accordance with Section 44
15. Any winnings from lottery, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form of nature whatsoever
16. Any sum received by the assessee from his employees as contributions to any provident fund or super annuation fund or any fund set up under the provisions of the Employees State Insurance Act, 1948 or any other fund for the welfare of such employees
17. Any sum received under Keyman Insurance Policy, including bonus

Explanation

From the above definition of the word income it will be clear that it is not possible to give a comprehensive definition of income. Particularly, in the diverse courses of modern trade, commerce and industry and in the ever-increasing and complex transactions of trade, commerce and industrial environment the money,

in cash or kind, passes from one person to another in different forms and shapes. It is therefore, impossible to define exhaustively which of such shapes or forms of receipt of money income for the purpose of income-tax is.

Criteria or Principles or Rules or Tests of Governing the Concept of Income:

1. **Regular and definite source:** The term 'income' connotes a periodical monetary return coming in with some sort of regularity or expected regularity from definite sources.
2. **Different forms of income:** Income may be received in cash or kind, when income is received in cash, valuation is to be made according to the Income Tax Rules. If rule is not prescribed, then the valuation is made on the basis of market value.
3. **Capacity or illegality:** The Income-Tax Law does not make any distinction between legality and illegality of income. Thus, the income earned by way of smuggling of gold is liable to income-tax.
4. **The periodicity:** The periodicity in the receipt is not the deciding factor to establish the nature of receipt as income. Lump sum receipt may also be treated as income if the other conditions satisfied.
5. **Basis of income:** Income arises either on receipt basis or on accrual basis. Income may accrue to a taxpayer without its actual receipt.
6. **Relief or reimbursement of expenses not treated as income:** Mere relief or reimbursement of expenses is not treated as income. For instance, reimbursement of travelling expenses to an employee is not an income.
7. **Diversion of income:** Whereby an obligation income is diverted before it reaches the assessee, it is 'diversion of income' and not taxable. Conversely, after earning the income if it is required to be applied to discharge an obligation it is merely an 'application of income' and income is chargeable to tax.
8. **Surplus from mutual activity:** A person cannot make taxable profit out of a transaction with himself. It means income must come from outside.
9. **Nature of income:** For the purpose of income-tax, there is no distinction between temporary and permanent income. Even temporary income is taxable.
10. **Devaluation of currency:** If any assessee receives extra money on account of devaluation of currency, it is taxable.

11. **Income includes loss:** While income, profits and gains represent “plus income”, losses represent “minus income” (CIT VS KaramchandPremchand Ltd.).
12. **Casual income:** Any receipt which is of casual nature is not an income. The casual receipt is the one which arises without any expectation to arise and which cannot be anticipated to recur in the future. These capital receipts are not income for the purpose of income-tax.
13. **Saving from expenses is not an income:** Pin money received by wife for her dress/personal expenses and small savings made by a woman out of money received from her husband for meeting household expenses is not treated as her income.
14. **Prize on winning a motor rally:** The prize on winning a motor rally is income (CIT Vs. G. R. Karthikeyan, 1993).

While considering the criteria of the income we may conclude that, by defining income as ‘including’ certain classes of receipts the Income Tax Act makes it clear that meaning of ‘income’ is not restricted to classes of receipts mentioned in the definition but also includes in its ambit the meaning of the terms as generally understood.

“Gross Total Income” means total income computed with the provisions of the Act before making any deduction under section 80 C to 80 U.

‘Total Income’ means the gross total income as reduced by the amount permissible as deduction under Sections 80 C to 80 U.

Check your progress 2

1. The income earned by way of smuggling of gold is _____ under income-tax.
 - a. Illegal
 - b. Liable to tax
 - c. legal

3.4 Person

Person

The term person is important in the context of Income-tax Act, 1961 as the charge of income-tax is on 'person'. The term person leads to the expression 'assessee'. Since the assessee is a person as defined in the Income-tax Act, Section-SCSI of the Act defines the term 'person' as under:

2(31) "Person" includes

1. An individual
2. A Hindu undivided family
3. A company
4. A firm
5. An association of persons or abody of individuals, whether incorporated or not
6. A local authority
7. Every artificial judicial person, not falling within any of the preceding sub-clauses

The definition of person is comprehensive and it is inclusive one. Every class of person is a unit of assessment; All the assesseeesarebroadly divided into above classes for the purpose of assessment of income-tax. These categories of persons are briefly discussed in the following paragraphs in this chapter.

3.4.1 Individual

The term individual means only a natural person or a human being. It includes both male and female. It also includes minor person, the assessment in respect of whose income is done on the guardian. An individual also includes the person of unsound mind, the assessment in respect of whose income is done on the trustee,

The concept of individual assumes a greater importance in the Income-tax Act since every individual is taxed separately on the income derived by him. Even if an individual is a member of a group of individuals deriving the taxable income, its entity as an 'individual' is separate from the entity of the group.

3.4.2 Hindu Undivided Family

A Hindu Co-parcenary (i.e. joint heirship or joint ownership) is the basis of a Hindu Undivided Family which includes only those persons who acquire by birth an interest in the joint or coparcenary property. A Hindu Undivided Family may get composed of male and female members. There need not be more than one male member to form a Hindu Undivided Family along with other female members. It is a case of a 'sole coparcener'. In such a case the tax is leviable on the joint family and not on the male members as an individual.

There can be a Hindu Undivided Family consisting of female members only.

In a Hindu Undivided Family consisting of the mother and her minor sons, the mother can act as manager. Even the eldest son, though minor, can also act as manager representing the family. In such a case, the assessment and recovery proceedings may be taken against the manager concerned.

The basic principle behind treating a HUF as distinct legal entity for income-tax assessment is that the income arising from common property of a HUF is subjected to tax in the hands of HUF as joint liability whereas the members of HUF are liable to tax only on their own income earned in their individual capacity.



Fig 3.1 Hindu Undivided Family

3.4.3 Company

‘Company’ is another taxable entity which is also a separate unit of assessment under Income-tax Act. For the purposes of Income-tax Act, the term ‘company’ has a much wider connotation than that under the Companies Act, Section-2(17) defines the term as under:

‘Company’ means

1. Any Indian company, or
2. Any body corporate incorporated by or under the laws of a country outside India, or
3. Any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922, or which is or was assessable or was assessed under this Act as a company for any assessment year commencing on or before the 1st day of April, 1970.
4. Any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the Board to be a company.

Provided that, such institution, association or body shall be deemed to be a company only for such assessment year or assessment year (whether commencing before the 1st day of April, 1971, or on or after that date) as may be specified in the declaration.



Fig 3.2 Company

Explanation

From the above definition it will be clear that, under the Income-tax Act, even an unregistered or unincorporated association may be declared to be a company. Thus, what is not a legal entity may be assessable as a company. Even a company registered under Section 25 of the Companies Act without a commercial or profit-motive will be assessed as a company for income-tax purposes.

As a company is treated as distinct legal entity separate from its shareholders, every company is treated as a separate unit of assessment different from the persons constituting it. The income derived by the company is thus taxable in the hands of company as such and no tax can be levied on the shareholders in respect of the income derived by the company. This principle of independent corporate personality of a company is very important in the context of income-tax assessment.

Different classes of companies: The definition of the term “company” under the provision of the Act indicate different classes of companies which are as under:

a. Indian Companies

According to Section 2(26) of the Act, an Indian company means a company formed and registered under the Indian Companies Act, 1956. Two conditions should be satisfied so that a company can be regarded as an Indian company. The company should have been formed and registered as an Indian company and secondly, the registered office of the company should be situated in India. Besides this, the following are also treated as Indian company:

- A company formed and registered under any law relating to companies formerly in force in any part of India (except the State of Jammu and Kashmir and certain Union territories)
- A statutory corporation established under a Central or State Act
- Any institution, association or abody which is declared by the Board as a company under Section 2(27)
- A company formed and registered under any law in force in the State of Jammu and Kashmir
- Any company formed and registered under any law in force in Dadraand Nagar Haveli, Goa, Daman and Divand Pondicherry

b. Domestic Company

- Indian company or
- Any other company which in respect of its income liable to tax under Income-tax Act, has made the prescribed arrangements for the declaration and payment within India of the dividends on preference shares payable out of such income

c. Foreign Company

A foreign company is one which is not a domestic company.

d. Company in which public is substantially interested

According to Section 2(18), the following companies are said to be companies in which the public is substantially interested.

- A company owned by the Government or the Reserve Bank of India or in which not less than 40 percent of the shares are held by the Government or the Reserve Bank of India or corporation owned by the Bank (The Government means either central or State but not foreign Government).
- A company having no share capital which is declared by the Board for the specified assessment year or year to be a company in which public are substantially interested
- A company which is registered under Section 25 of the Companies Act, 1956, formed for promoting commerce, arts, science, religion, charity or any other useful object
- A company which is not a private company subject to fulfilment of certain conditions
- A company which carries on as its principal business, the business of acceptance of deposits from its members

3.4.4 Firm

A partnership firm is recognized as a separate entity from its partners. Under the Income-tax Act also it is different and distinct unit of assessment. According to Section 2 (23) of the Act the terms 'firm', 'partner' and 'partnership' have the same meanings as assigned to them in the Indian Partnership Act. However, for

the purpose of income-tax assessment it also includes a minor who has been admitted to the benefits of the partnership.

According to Section 4 of the Indian Partnership Act, partnership is the relation between persons who have agreed to share the profits of the business carried on by all or any of them acting for all. The persons who have entered into partnership are called as partners and they are collectively called as 'firm'. Following are the essential characteristics of the partnership firms:

- It is a relationship arising out of a contract between persons. The contract may be verbal or in writing.
- Sharing of profits is a vital condition of partnership. No partnership can come into existence unless there is an agreement to share profits,
- There should be at least two persons or more persons to form a partnership. The persons may be individuals or artificial persons like company etc. A minor cannot enter into partnership but he can be admitted to the benefits of the partnership,
- The partnership firm must carry on the business which includes every trade occupation and profession.
- The business of the partnership firm may be carried on by any one or more acting for all or by all. The act of one partner is binding upon all others and similarly, he would be bound by what other partners do in carrying on the business.



Fig 3.3 Firm

3.4.5 Association of Persons and Body of Individuals, Associations of Persons whether Incorporate or not

The phrase 'association of persons' is most comprehensive and under Sec. 3 (42) of the General Clauses Act, the 'person' includes any company, association or body of individuals, whether incorporated or not. Thus, an 'association of persons', may have its member companies, firms, joint families and associations.

Under Sec. 86 (v) a member of an association is not liable to pay tax again in respect of his share in the benefits of the association on which the tax has already been paid by the association.

In order to constitute an 'association of persons', the persons must join in a common purpose or common action and the object of association must be to produce income. It is enough that all the members - persons receive the income jointly. Co-heirs, Co-legatees, Co-donees and other joining together in a common purpose or action will be chargeable as an 'association of persons'.

3.4.6 Body of Individuals

When the members concerned come together with the main intention to receive income jointly, their association is described as a 'Body of Individuals'. If the co-trustees and co-executors whose title and interests are indivisible and who merely receive jointly incomes such as dividend, interest etc., they will be more appropriately assessable as a 'Body of Individuals'.

3.4.7 Local Authority

A municipal committee, district board, body of port commissioners and other such authorities are known as 'Local Authorities'. Such authorities are legally entitled to or entrusted by the Government with the control or management of municipal or local funds. A local authority is taxable only in respect of its income which arises from any business carried on by it in so far as that income does not arise from the supply of commodity or services within its own jurisdictional areas, For and from the assessment year 1972-73 income arising from the supply of water and electricity even outside the local authority's jurisdictional area is exempted from tax.

3.4.8 Artificial Judicial Persons

This category covers every artificial person not falling under any other heads. It mainly refers to the private religious trusts. An idol or deity would be assessable in the status of an artificial person. As an example, Tirupati Devasthan would be covered under this category of persons.

Check your progress 3

1. The term individual means a_____.
 - a. Natural person
 - b. A company
 - c. Natural person and a company
 - d. All of the above

3.5 Assessee

The provisions of the Income tax Act, 1961 levy the income-tax on the income earned by the 'assessee'. An 'assessee' is responsible for discharging the liability under the Income-tax Act. It is therefore, very important to study the meaning of the term assessee used in the Act. Section 2(7) of the Income-tax Act defines the term assessee as follows.

“Assessee” means a person by whom any tax or any other sum of money is payable under this Act and includes -

- Every person in respect of whom any proceeding under this act has been taken for the assessment of his income or of the income of any other person in respect of which he is assessable, or of the loss sustained by him or by such other person, or of the amount of refund due to him or to such other person
- Every person who is deemed to be an assessee under any provision of this act
- Every person who is deemed to be an assessee in default under any provision of this act



Fig 3.4 Tax

Act Explanation

From the above definition it can be noted that the 'assessee' means a person as defined in Section 2(31) of the Income-tax Act, by whom any tax or any other sum of money is payable under the Income-tax Act. Any other sum of money payable under the Income-tax Act would include the interest or penalty levied under relevant provisions of the Act.

The expression assessee used in the Act also includes every person in respect of whom any proceedings under the Act are taken for the assessment of (a) his income, (b) his loss and (c) amount of refund due to him. Thus the definition of the term assessee under the Income-tax Act covers two categories of the person.

- The persons by whom any tax, penalty or interest is payable under the Act, whether any proceedings under the Act have been actually taken against them or not. This category covers the person whose taxable income under the Income-tax Act exceeds the basic exemption limit prescribed under the Act.
- The persons against whom any proceedings under the Act have been taken, whether or not they are liable to pay tax, penalty or interest under the Act. This part of definition of the term assessee enables Income-tax authorities to initiate the proceedings against any person for assessment of his income or loss under the provisions of the Act.

Deemed Assessee

The clause (b) of the definition of 'assessee' also includes every person who is deemed to be an assessee under any provisions of the Act. Section 159 of the Act provides that when a person dies, his legal representative is liable to pay any sum which the deceased person would have been liable to pay, had he not died.

Thus the legal representative will be held as assessee in respect of the income of the deceased person and any proceedings taken against the deceased person before his death shall be continued against the legal representative. All the provisions relating to assessments, penalty or interest, service of notice etc. will be equally applicable to the legal representative. Similarly, the 'executors' who are liable to income-tax in respect of income of the deceased under the provisions of Section 169 of the Act will also be treated as an assessee for the purpose of income-tax assessment.

Deemed assessee in default

Clause (c) of the definition of term assessee also covers every person who is deemed to be an assessee in default under any provisions of the Act. In certain circumstances, the provisions of Income-tax Act (Sec. 194) requires the person paying income to other person to deduct the income-tax at source and pay it to the Government within the stipulated time period. Section 201 of the Act provides that if any such person does not deduct or after deducting fails to pay the tax as required under the Act, he shall be deemed to be an assessee in default. Thus, in respect of the income-tax liable to be deducted at source) the person paying the income tax will be considered as an assessee and any proceedings under the Act will be taken against such person.

Check your progress 4

1. _____ means a person by whom any tax or any other sum of money is payable under this Act
 - a. Individual
 - b. "Assessee"
 - c. person
 - d. company

3.6 Assessment Year

It is a period of 12 months commencing on the 1st day of April immediately after the previous year. For example, for previous year ending 31st March 2010, the assessment year is 2010-2011 (i.e. from 1.4.2009 to 31.3.2010). Income of the previous year of an assessee is taxed during the next following prescribed by the relevant Finance Act. [Section 2(9)]

Previous Year

In the language of Income Tax Act, previous year is the financial year ending on 31st March every year. [Section 3]

Income of the previous year of an assessee is taxed during the next following assessment year at the rates prescribed by the relevant Finance Act.

Income earned in a year is taxable in the next year. The year in which income is earned is known as previous year and the next year in which income is taxable is known as assessment year.

From the assessment year 1989-90 onwards, all assessee are required to follow financial year (i.e. April 1st to March 31st) as the previous year. The uniform previous year has to be followed for all sources of income.

In case of a newly set-up business/profession or in the case of a new source of income, the first previous year will be from the starting of new business/profession or on the date when the new source of income comes into existence till immediately following 31st March. The duration of the first previous year may be of 12 months or less. Second and subsequent previous year will be as usual, i.e. from 1st- April to 31st March.

Check your progress 5

1. Financial year and the assessment year both are _____ under income tax act.
 - a. Same
 - b. Different
 - c. Different but same

3.7 Agricultural Income

The term 'Agricultural Income' has been defined in Sec. 2(1) of the Income Tax Act, 1961, as follows:

'Agricultural Income' means

- Any rent or revenue derived from land which is situated in India and is used for agricultural purposes :
- Any income derived from such land by (i) agriculture or (ii) the performance by a cultivator or receiver of rent-in-kind of any process employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him is to be taken to market or (iii) the sale by a cultivator or receiver of rent-in-kind of produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in paragraph (i) of this sub clause :
- Any income derived from any building owned and occupied by the receiver of the rent or revenue of any such land, or occupied by the cultivator or the receiver or rent-in-kind, of any land with respect to which or the produce of

which, any process mentioned in paragraphs (ii) and (iii) or sub-clause (b) is carried on, provided that

- The building is on or in the immediate vicinity of the land and is a building which the receiver of the rent or revenue or the cultivator or the receiver of rent-in-kind, by reason of his connection with the land, requires as a dwelling-house, or as a store-house, or other out-building and
- The land is either assessed for land revenue in India or is subject to local rate assessed and collected by the officers of the government as such or, where the land is not so assessed for land revenue not subject to a local rate, it is not situated
 - a. In any area which falls within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee or by other name) or a cantonment board and which has a population of not less than 10,000 according to the latest preceding census of which the relevant figures have been published before the first day of the previous year.
 - b. In any area within such distance, not being more than eight kilometers from the local limits of any municipality or cantonment board referred to in item (a), as the central government may, having regard to the extent of and scope for urbanization of that area and other relevant considerations, specify in this behalf by notification in the official gazette.

From the definition and various provisions given above, it can be concluded that the receipt can be treated as 'Agricultural Income' provided it satisfies the following conditions:

- The income must be derived from land
 - Such land must be situated in India
 - The land must be used for agricultural purposes
 - The income derived from the building may also be treated as agricultural income provided it satisfies the condition prescribed above in sub-clause (c).
- Explanatory of conditions and their relevance to agricultural income

The conditions and their relevance to agricultural income are explained as follows:

1. Income must be derived from the land -

The agricultural income may be received in the form of rent or revenue derived from land. The term 'derived from land' means that the income must be 'arisen out' of land. Thus, the land should be immediate and effective source of income to treat the income as the agricultural income. If the relation between land and the income is not direct or primary one, the income cannot be treated as agricultural income.

Following are the examples of some of the types of revenue derived in relation to or by virtue of land, yet those cannot be treated as agricultural income since those incomes are not directly associated with the land and the land cannot be said as effective or immediate source of the revenue.

- Maintenance charges paid on agricultural land cannot be said to be derived out of land.
- An annuity paid by the transfer of the land to the transferor of the land under the contract is not an income derived from land.
- The amount of salary received by the manager of the agricultural farm is not an agricultural income as there is a not direct annexe between the salary income and the agricultural land. The salary is earned for the personal services rendered to the employer; it neither derives out of cultivation of land nor out of personal association to the agricultural land.

2. The land must be situated in India -

The land out of which the income is derived must be situated in India. To other words, the income derived from the land situated in any foreign country will not constitute the agricultural income within the meaning of Section 2(1) of the Income-tax Act and such income, if derived by the citizen resident in India, will be chargeable to income tax.

3. The land must be used for agricultural purposes -

The income derived from land will constitute the agricultural income only if such land is used for the agricultural purposes. To elaborate this principle, one has to understand what is meant by 'agriculture'. The agriculture means cultivation of land, that is to say the process of tilling of the land, sowing of seeds and other incidental operations performed on the land. These operations, to treat them as

agricultural operations, require the human skill and labour to be consumed in the land.

Thus, all direct operations carried on directly on the land in the process of cultivation of land constitute agriculture. Any subsequent operation after the produce has arisen from the land, such as digging, cutting etc. cannot be said to have performed on the land itself and thus such subsequent operations are not agricultural process in the context of Income-tax Act, unless they are carried on in continuation of the basic operations of the cultivation. Thus, it follows from the above that the income must be derived from performing the primary agricultural processes of cultivation on the land to constitute it as agricultural income. The income derived from the sale of forest trees, which grow spontaneously, cannot be treated as agricultural income because no processes are performed on the land for the growth of the trees and the process of spontaneous growth of trees is not the agricultural process.

4. Income from building situated in the vicinity of the land -

Clause (c) of subsection (1) of Section 2 of the Income tax Act specifies that the income derived from any building on the agricultural land would constitute the agricultural income if following conditions are satisfied:

- The building must be on or in immediate vicinity of the agricultural land.
- The building should be owned and occupied by the cultivator of the land or by receiver of the rent or revenue from such land, in respect of which land, the processes ordinarily employed by the cultivator or receiver of the rent or revenue, to render the produce raised by him fit to be taken to the market for sale are carried on.
- The building must be used by the cultivator or receiver of revenue or rent as his dwelling house by reason of his connection with land or as a store house or other outhouse.

Thus, the income derived from the godown or shed situated on the land used for agricultural process for storing the grains raised on the agricultural land is to be treated as agricultural income and consequently it will be exempt from income-tax. Similarly, the income earned from the farm house constructed on the land which is used by the owner or cultivator of land for his residence, would constitute the agricultural income.

5. Income from agricultural produce and from marketing agricultural produce -

The clause (b) of the sub-section (1) of section (2) of the Income-tax Act deals with the income derived from land by

- Agriculture
- The performance of any process ordinarily employed by a cultivator or the receiver of rent in kind to render the produce raised by him fit to be taken to market or
- The sale of the produce raised or received by a cultivator or receiver of rent in kind in respect of which no process other than the one which is ordinarily performed by a cultivator has been performed.

Thus, the income derived from the process of growing agricultural produce and other incidental processes to make the agricultural produce fit to be taken to the market for sale, will be agricultural income. However, the processes carried on the agricultural produce must retain the original character of the produce, otherwise the income derived from the sale of the agricultural produce after transforming it into the entirely new form and shape cannot be treated as agricultural income.

Examples:

1. The income derived from sale of wheat grown on the land is agricultural income, but the income derived from processing it into wheat flour and sale proceeds of such wheat flour does not constitute an agricultural income within the meaning of Sec. 2 (1) of the Income-tax Act, 1961.
2. The cotton grower need not convert his cotton into suitable thread because there is already market for all types of cotton. Therefore, for deciding income chargeable for taxation, the market price of the cotton used for threading will be deducted- from the total income.
3. If a sugar factory is using sugarcane grown on its own farm, the entire income cannot be treated as the agricultural income. Because a cultivator of sugarcane can sell his produce without converting it into sugar. It means production of sugar does not form a part of cultivation activities. The income chargeable for taxation should be decided accordingly. It can be done by deducting the market price of sugarcane from the total income; and the rest of the income becomes taxable.

4. The green tea leaf is a marketable commodity. If a tea-estate has undertaken manufacturing of tea suitable for consumption, such manufacturing activity does not form a part of cultivation activities. Therefore, the market price of the green tea leaf will be deducted from the total income while arriving at the income chargeable for taxation.

Check your progress 6

1. Agriculture income is _____ under income tax act.
 - a. Exempted
 - b. Taxable
 - c. Partially taxable

3.8 Residential Status

The residential status of an assessee decides the extent of his taxable income. It is determined solely on the basis of physical presence and/or other prescribed criterion as against nationality or domicile of the individual, It is determined for every previous year separately. A person may be a resident in one previous year and non-resident in next year. The prescribed tests for determining the residential status are given in following part:

1. Residents in India -

- a. Individual is 'Resident' if any of the following condition is satisfied:
 - Stays in India for 182 days or more during the previous year; or [Sec. 6(1) (a)]
 - Stayed in India for 365 days or more during the four preceding years and stays in India for atleast 60 days during the previous year (182 days in case of an Indian citizen or a person of Indian origin' coming on a visit to India or in; case of an Indian citizen going abroad as a member of the crew of an Indian ship or for employment).
[Sec. 6(c)] Note: Stay in India may be continuous or intermittent.

- b. Hindu Undivided Family or Firm or other Association of Persons is Resident of India in any previous year except where the control and management of its affairs is wholly situated outside India in that previous year. [Sec. 6(2)]
- c. Company is resident of India if
- It is an Indian company.
 - During the previous year its control and management is situated wholly in India.
- [Sec. 6(3)]
- d. Every other person is treated as resident in India in any previous year except in the case where the control and management of its affairs is situated wholly outside India. [Sec6(5)]

Note: A person resident in India, in a previous year in respect of any source of income shall be deemed to be resident in India in respect of his other sources of income as well.

2. Non-Residents

A person is non-resident if he is not resident in India. For details see chapter on “Non-Resident”. [Sec. 2(30)]

3. Not Ordinarily Resident:

In Section 6 of the Income-tax Act for clause (6), the following clause shall be substituted w.e.f. 1st day of April 2004 (assessment year 2004-05 and onwards) namely:

“A person is said to be “not ordinarily resident” in India in any previous year if such person is -

- An individual who has been non-resident in India in nine out of the ten previous years preceding that year, or has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and twenty nine days or less; or
- A Hindu undivided family whose manager has been a non-resident in India in nine out of the ten previous preceding that year, or has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and twenty nine days or less. [Sec. 6(6)]

Residential status and total income:

Incomes are to be included in total income.

It depends upon the residential status of the assessee.

In case of Resident Persons, incomes received, accrued, arisen or deemed to be received, accrued or arisen in India, are to be included. Also income which accrue or arise outside India are to be included.

In case of Not Ordinarily Resident Persons, incomes received, accrued, arisen or deemed to be received, accrued or arisen in India are to be included. Income which accrues or arises outside India from a business controlled in India or a profession set up in India is also to be included.

In case of Non-resident Persons, incomes received, accrued, arisen or deemed to be received, accrued or arisen in India, are only to be included. [Sec. 5]

Income is chargeable to tax either on accrual basis or on receipt basis, whichever is earlier. However, if an income has been taxed on accrual basis, it shall not be taxed again on receipt basis.

Example: Residential Status and Accessibility of Income

Mr. X has the following incomes during the Assessment Year 2010-11 (Previous Year 2009-10):

- a. Dividends on shares in Indian companies credited to his account Rs. outside India. Rs.15000
- b. Interest on bank accounts in India Rs. 15000
- c. Royalty from books published in India Rs.60000
- d. Interest on capital from firm outside India but controlled in India Rs.75000
- e. Remuneration for technical services rendered outside India, paid by an Indian company. 150000
- f. Interest on bank deposits outside India. Rs. 45000

Total income of Mr. X shall be -

- (i) If Mr. X is 'Resident' in India

$$\text{Gross Total Income} = (a) + (b) + (c) + (d) - (e) + (f) = \text{Rs. } 3,60,000$$

Note: Dividend received on shares is not exempt from the assessment year 2003-04 and onwards.

- (ii) If Mr. X is 'Resident but Not Ordinarily Resident'

Gross Total Income = (b) + (c) + (d) = Rs. 1, 50,000

Interest on foreign deposits and remuneration for technical services rendered outside India payable by a resident person are not deemed to accrue or arise in India.

(iii) If Mr. X is 'Non-Resident'

Gross Total Income = (b) + (c) = Rs. 75,000

In case of Non-Residents foreign incomes are excluded.

Residential Status of an Assessee:

Residence:

The incidence of Income-tax of any assesses depends upon his residential status under the Income-tax Act. The taxability of a particular receipt in the hands of the assessee would thus depend upon not only, the nature of the income, but also upon the assessee's residential status.

The relevant provisions relating to the residence of the assesses are contained in Section 6 of the Income-tax Act, 1961. These provisions are to be applied strictly as per their meaning in the Act. The provisions of Section 6 being very clear; there is no scope for any dispute regarding residential status of the assessee. The provisions of Sec. 6 of the Act are reproduced below:

For the purposes of this Act

- 1. An individual is said to be resident in India in any previous year, if he
 - a. Is in India in the previous year for a period of 182 days or more
 - b. Is in India for a period of 60 days or more during the previous year

365 days more during 4 years immediately proceeding the previous year. Accordingly, the residence of any person may be classified into the following three categories:



Fig 3.5 Type of Residents

Residence of an assessee may be studied under the following separate classes:

1. Individual/ person
2. Hindu Undivided Family
3. A Company
4. Any other person

1. Individual

An individual is said to be resident in India during the relevant previous year if he satisfies certain conditions. The Act divides the conditions into the following two categories, namely, category A and category B.

Category A:

An individual has to satisfy any one of the following two conditions:

1. He has been in India for a period or periods amounting in all to 182 days or more.
2. He has been in India for a period or periods amounting in all to 365 days or more within the four years immediately preceeding the relevant previous year and that he is in India for a period or periods amounting in all to 60 days or more during that year.

Explanation:

1. The stay in India in all the above cases need not be continuous for those days. It may be in parts and such stay need not be at the same place.
2. If an individual (who is a citizen of India) leaves India for the purpose of employment outside India or as a member of the staff of an Indian ship, the period of 60 days or more as in (2) above shall be 182 days or more.
3. If a citizen of India comes to India on visit, he can stay in India upto 89 days during the relevant previous year.

From 1st April, 1990, the period of 60 days or more as in (2) above will be 150 days or more.

4. The personal presence in India of an individual is required. Therefore, the above conditions are applicable to individual only and none else (i.e. Firms, companies).

Category B:

An individual has to satisfy both the following conditions (after satisfying at least one of the conditions in category A):

1. He has been resident in India in 9 out of 10 years immediately preceding the relevant previous year.
2. He has been in India for a period or periods amounting in all to 729 days or less during seven years immediately preceding the relevant previous year.

Explanation:

1. If an individual satisfies conditions under both the above categories (i.e. A and B), he will be resident and ordinarily resident.
2. If he satisfies either or both the conditions under category A, but does not satisfy both the conditions under category B, he is said to be resident but not ordinarily resident.
3. If he does not satisfy any one of the conditions of category A, he is said to be anonresident. It does not matter whether he satisfies one or both the conditions under category B. 2, Hindu Undivided Family, Firm or Other Association of Persons:

The following test of residence has to be fulfilled by these bodies to acquire the status of the 'Residence in India'. Test for 'Residence in India':

According to Sec. 6 (2), a Hindu Undivided Family, Firm or other association of persons is resident in India if the control and management of its affair is situated wholly or in part in India. Explanation:

- a. Control and Management:** The expression 'Control and Management' signifies the power of controlling and directing the business affairs. It is sometimes described as the 'head and brain' of business. It means that the term 'Control and Management' is used specifically to denote the right of the top management to take decision and control and direct the business affairs. Therefore, it certainly differs from the act of running business.
- b. Place of Control and Management:** The expression 'Situated' used in Sec, 6(2) implies the functioning of controlling and directive power at a particular place with some degree of permanence and stability. It indicates the place from where the business is being controlled and managed. If such a place of control and management of business is

wholly or in part situated in India, the HUF, firm or other association of persons will get the status of a 'Resident in India'.

- c. **Residence of Members:** The residence of individual members of the HUF. Firm or other association of persons is immaterial in determining the residential status of the HUF etc., except where it affects the control and management of the business.
- d. **Affairs:** It includes all those activities which are relevant for the purpose of the Income Tax Act and have some relation to the income sought to be assessed. Mere activities, even by the Karta or the manager, do not constitute affairs.
- e. **Place of Business:** The place of business where the HUF and other bodies undertake a great deal of business can be altogether different from the place of control and management of business affairs. Thus, both these could be different places situated far away from each other. But the residential status will be decided only on the basis of the place of 'control and management' and not on the place of business.
- f. **Division of Seat of Management and Control:** The seat of management and control could be divided at two different places and it is expected that at least one of such seats should be situated in India. It means at least a part of management and control should be in India for the HUF and other bodies to acquire the status of a 'Resident in India'.
- g. **Occasional visits of Non-Resident Karta:** A 'non-resident' Karta having places of the HUF business in India might occasionally visit them and casually issue directives in respect of business. In such a case, it should be noted that such an act of directing business does not constitute the 'Control and Management' of business of India. As a result, the HUF is not entitled for a status of a resident in India. Not Ordinarily Resident in India:

It should be clearly noted that the Partnership Firms and other Associations of Persons do not come under the category of 'not ordinarily resident in India'. Only Hindu Undivided family comes under this category.

In the entire set up of the Hindu Undivided Family the position of the Karta is very important and therefore, his residential status is

considered while classifying the HUF as 'not ordinarily resident in India' for the purpose of income tax.

According to Sec. 6 (b) of the Income Tax Act, 1961, the Hindu Undivided Family is said to be 'Not Ordinarily Resident in India' provided

- Its manager has not been resident in India in nine out of ten previous year preceding that year or
- Its manager has not, during the seven previous years preceding that year, been in India for a period or periods amounting in all to seven hundred and twenty nine days or less

Non-Resident in India:

The Hindu Undivided Family, Partnership Firm or other Association of Persons are 'Non-resident' only when the control and management of their affairs is situated wholly outside India.

Check your progress 7

1. The _____ of an assessee decides the extent of his taxable income.
 - a. residential status
 - b. income
 - c. sources of income

3.9 Companies

Resident in India

According to Sec. 6(3), a company is said to be resident in India in any previous year, if

- It is an Indian company or
- During that year, the control and management of its affairs is situated wholly in India

Explanation

- a. **Indian Company:** Every Indian Company is deemed to be resident in India even if its control and management is situated wholly or partly out of India. The term 'Indian Company' is specifically defined in Sec. 2 (26) of the Income Tax Act, 1961.
- b. **Non-Indian Company:** A non-Indian company is a company which falls beyond the provisions of the Sec. 2 (26) of this Act. Such a non-Indian company is deemed to be a resident in India only if its control and management is situated wholly in India.
- c. **Place of Control and Management:** In the case of a joint stock company, the place of control and management is that place where the meetings of the Boards of Directors are held. This is the final test to decide where the control and management of a company is situated.
- d. **Place of Shareholders:** The place of control and management of a company's affairs does not go along with the place of shareholders even if any one of them or a group of shareholders hold an absolute majority of shares and thereby have a decisive voice in matters relating to the company's affairs.

Non-Ordinarily Resident: A company is never given a status of 'Non Ordinarily Resident'.

Non-Resident: A company which does not satisfy any of the aforesaid conditions of residence will be a 'Non-Resident' company.

Other Persons/entity:

The residential status of any other class of assessee, being local authorities or artificial judicial person like idols, deities etc. is to be determined by ascertaining whether the control and management of the affairs of the assessee exercised from India or outside. In any accounting year even if only part of the control is exercised from India, the assessee will be treated as resident in India. In other words, the assessee will be nonresident only when its control and management is wholly exercised from outside India.

Example:

1. Mr. Niteen is a citizen of India. He left for France for employment on 1st June 2009 and came to India on 8th January 2010 on 3 months leave. He again went to France on April 2010. Determine the residential status of

Mr.Niteen for the financial year ended 31st March 2010 i.e. assessment year 2010-11.

Solution:

- a. Mr.Niteen visited India and stayed in India for 83 days [i.e. 24 days in January, 28 days in February and 31 days in March] during the financial year 2009-10. Thus he does not satisfy the first basic condition of stay of more than 182 days.
 - b. Although he was in India for more than 365 days during 4 years preceding the financial year 2009-10, as he is coming from outside India, he has to satisfy the condition of stay of more than 150 days' during the financial year 2006-07. Since Mr.Niteen stayed in India for 83 days only, he does not satisfy this condition also. In view of (a) and (b) above Mr.Niteen will be treated as 'Non-Resident' for the assessment year 2010-11.
2. Mr. Vishal has been a resident in India since 1952 and left for England on 5th June 2007 on employment contract. He came back to India on 5th February 2009 and continued his service with his previous employer. What will be the residential status of Mr. Vishal for the financial year ended 31st March 2010?

Solution: Mr. Vishal has been in India for 55 days only [i.e. 24 days in February plus 31 days in March]. As he is in India for less than 60 days during the financial year 2009-10, his status will be that of non-resident.

3. Mr. Kale came to India for the first time on 16th June 1999 and has been staying in India since then. Determine the residential status of Mr. Kale for the financial year 2009-10.

Solution: Mr. Kale has stayed in India for more than 182 days during the financial year 2009-10. Thus, he satisfies the basic condition of the test of residence.

As regards additional conditions, he satisfies one of the conditions of stay of more than 730 days during 7 preceding years. However, he does not satisfy the second additional condition i.e. has not been resident in 9 out of the 10 previous years preceding the year 2009-10 as he came to India only in 1999 i.e. 9 years back. Mr. Kale is therefore, resident but not ordinarily resident during the financial year 2009-10.

4. M/s ABC (HUF) a Hindu undivided family is engaged in the business of sale and purchase of machinery in the International market. The business is mainly run through branch offices situated at London and Geneva. The Manager (Karta) of family, Mr.Yogiraj has never gone abroad in connection with the business. He controls the business from India only. What will be the status of family for income-tax assessment?

Solution: The control and management of the HUF business is not situated wholly outside India in view of the fact that its Manager Mr.Yogiraj is resident in India and controls the business of HUF. Thus, the HUF will be treated as resident in India.

5. M/s Shyam Eng. Ltd., an Indian company registered under the Companies Act, 1956, is engaged in the business of trading in the engineering goods. Its main domain of the trading activity has been in Japan. Every alternate meeting of Board of Directors is being held at Tokyo in Japan when the policy decisions are being taken. What will be the residential status of M/s Shyam Eng. Ltd, for income-tax purposes?

Solution: M/s Shyam Eng. Ltd. being an Indian company satisfied the first condition of the residence. The company will therefore, be treated as resident in India although its control and management is situated outside India.

Check your progress 8

1. Every _____ Company is deemed to be resident in India even if its control and management is situated wholly or partly out of India
- a. Foreign
 - b. Indian
 - c. multinational

3.10 Incomes Exempted from Tax

In the following cases income is absolutely exempt from tax, as it does not form part of total income the burden of proving that a particular item of income falls within this section is on the assessee. A complete list of all the incomes that are totally exempt from tax under various clauses of section 10 is given on next page.

1. **Agricultural income** - Income from agriculture is exempt. However, the net agricultural income is taken into account for determining the rates of income-tax on incomes, liable to tax. [Sec. 10(1)]
2. **Receipt from Hindu Undivided Family** - Any sum received by an individual as a member of Hindu Undivided Family where such sum has been paid out of the income of the family or in the case of any impartible estate, where such sum has been paid out of the income of the estate belonging to the family subject to section 64(2). [Sec. 10(2)]

However, any sum received from unrelated persons on or after 1/9/2004 by an individual or HUF in cash or by way of credit (other than by ways of consideration of goods and services) above Rs. 50,000 to be taxed as income in the hands of receiver. However, gifts on occasion of marriage to be exempt upto Rs. 1,00,000/- (w.e.f. 1/04/2005 by the Finance Act, 2004).

- a. **Share of profit from partnership firm:** In the case of a person being a partner of a firm which is separately assessed as such, partner's share in the total income of the firm is exempt. Share of partner of the firm shall be computed by dividing the taxable profits of the firm in the profit sharing ratio mentioned in the Partnership Deed. [Sec. 10(2A)]
3. **Casual and non-recurring receipts** - Section 10 (3) is omitted. Hence, the exemption of Rs. 5,000 in respect of casual and non-recurring receipts. (Rs. 2,500 in respect of winning from races including horse races) shall not be available from assessment year 2003-04 and onwards.
4. **Interest to non-residents** - Any income from interest on securities/bonds specified by the Central Government in Official Gazette. Premium on redemption of bond is also exempt. The- Central Government shall not notify/specify securities and bonds on or after 1-6-2002. As such interest premium on investments in securities/bonds issued on or after 1-6-2002 will not be exempt. [Sec. 10 (4) (i)]

- a. **Interest on Non-Resident External Account:** Any income arising to a person resident outside India or a person who has been permitted by the Reserve Bank of India to maintain such account from interest on money standing to his credit in a Non-Resident (External) Account in India. [Section 10 (4) (ii)]

However, there is no tax exemption w.e.f. 1/09/2004 in respect of interest from a NRE account and interest paid by scheduled banks to non-residents and not ordinarily residents on deposits in foreign currency (w.e.f. assessment year 2005-06 and onwards).

- b. **Interest on Specified Saving Certificates:** Interest on specified saving certificates of the Central Government received by a Non-Resident India, is exempt, provided such certificates have been subscribed to in convertible foreign exchange remitted from outside India through official channels, the exemption is restricted to interest on such certificates issued before 1-6-2002. Hence, interest on certificates issued on or after 1-6-2002 will not be exempt

5. **Value of leave travel concession in India** - Value of any leave travel concession or assistance received by or due from the employer to employee (including non-citizens) and his family (spouse, children and dependent-father, mother, brother, sister dependent on him) in connection with his proceeding on leave or after retirement or termination of his service to any part of India. [Sec. 10(5)]

6. **Remuneration of a foreign technician in India** - [Section 10 (5B)] is omitted. Tax paid by the employer in relation to salary/remuneration paid during the financial year ending 31-3-2003 and subsequent years will be treated as perquisites and grossed up under Sec. 195 (A) from assessment year 2003-04 and onwards.

7. **Income exempt in respect of foreigners** -

- **Passage money:** Section 10 (6) (i) is omitted. Hence, payment received for passage out of India will not be exempt from assessment year 2003-04 and onwards.
- Remuneration to an official of Embassy, High Commission, Legation, Affairs, Commissioner, Consulate or trade representative of a foreign State, or as a member of staff of any of these officials. Remuneration to staff of the Ambassador, Consul de carries, trade commissioner etc. [Sec. 10(6) (ii) (iii) (iv) and (v)]

- Remuneration received by employees of foreign enterprises. (Sec. 10(6) (vi)]

Salaries to non-residents employed on a foreign ship. [Sec. 10(6) (viii)]

- Remuneration received by certain foreigners, on training in certain establishments. [Sec. 10 (6) (xi)]

7(A) Tax paid on behalf of a foreign company in respect of certain income: The amount of tax paid by Government or an Indian concern on behalf of a foreign company in respect of royalty or fees for technical service paid under the agreement approved by the Central Government, will not be included in computing the total income of foreign company. No such approval is required where the agreement is in accordance with the Industrial Policy of the Government.

Section 10 (6) (A) is amended as follows:

The exemption is restricted to agreements executed before 1-6-2002. In respect of agreements executed on or after 2002 exemption is not available from assessment year 2003-04 and onwards. [Sec. 10 (6A)]

7(B) Tax paid on behalf of non-residents/foreign companies in respect of other incomes: Amount of tax paid by Government or an Indian Concern on behalf of a non-resident or a foreign company in respect of its income will not be included in computing the total income of such non-resident or foreign company.

Section 10 (6) (B) is amended as follows:

The exemption is restricted to agreements executed/approved before 1-6-2002. In respect of agreements executed/approved on or after 1-6-2002, exemption is not available from assessment year 2003-04 and onwards. [Sec. 10(6B)]

7(C) Tax paid by an Indian company on behalf of a foreign Govt. or a foreign enterprise under an agreement entered after 31.3.1997 but before 1.4,1999 and approved by the Central Government for acquiring an aircraft or an aircraft engine on lease.

[Sec. 10(6BB)]

7(D)Income by way of fees for technical services, received by a foreign company under an agreement with the Central Govt. in connection with projects of Indian Security.

From assessment year 2004-05 and onwards exemption is also available to income by way of royalty under such agreements. [Sec. 10(6C)]

8. **Foreign Allowances/Perquisites for services rendered outside India** paid or allowed outside India by the Government to an Indian citizen. [Sec. 10(7)]
9. **Income of a foreign Government employee under co-operative technical assistance programme**: Income of an individual who is assigned duties in India in connection with any co-operative technical assistance programme or project under an agreement between Government of India and a foreign Government in the form of remuneration received directly or indirectly from such foreign Government and any other income which accrues or arises outside India and is taxable in such foreign country.

[Sec. 10(8)]

9(A)Income of a non-resident Consultant under a Technical Assistance Grant Agreement: Income of a consultant who is engaged by an international organisation (hereinafter called 'agency') for rendering technical services in India in connection with any technical assistance programme or project under an agreement, approved by the prescribed authority, between the Central Government and the agency. Income of the consultant in the form of any remuneration or fee received directly or indirectly out of the funds made available to the agency and any other income which accrues or arises outside India and is taxable in the country of consultant's origin, [Sec. 10(8A)]

'Consultant' means an individual who is either not a citizen of India or is not ordinarily resident in India, or any other non-resident person.

9(B) Income in connection with any technical assistance programme: Income of an individual who is an employee of a Consultant referred to in clause (8A) above and is assigned duties in India in connection with any technical assistance programme or project under an agreement [referred to in clause (8A) above, in the form of remuneration received directly or indirectly from such Consultant and any other income which accrues or arises outside India and is taxable in the country of his origin. The

individual/employee should either be not a citizen of India or not ordinarily resident in India. [Sec. 10(8B)]

- 10. Income of a family member of an employee serving under co-operative technical assistance programmes:** Income of a family member of an individual referred to in clauses (8), (8A) or (8B), as the case may be, accompanying him to India, which accrues or arises outside India and is liable to tax in that foreign State or the country of origin of such member. [Sec. 10(9)]

11. Death-cum-Retirement Gratuity:

- a. Any death-cum-retirement gratuity under the Pension Rules of the Central Government or Central Civil Service Pension Rules, 1972 or under any similar schemes received by all categories of Central and State Government Employees.
- b. Any gratuity received under the Payment of Gratuity Act, 1972.
- c. Any other gratuity received by the employee, his widow or dependents to the extent it does not exceed one-half month's salary for each year of completed service taking average salary of ten months subject to a maximum of Rs. 3,50,000. [Sec. 10(10)]

11(A) Commuted Pension: Any payment in commutation of pension

- a. Received under the Civil Pension Commutation Rules or under any other schemes by a Central/State Government employee.
- b. Received from any other employer subject to the limit not exceeding:
 - In case where the employee received any gratuity then 1/3rd of the commuted value of such pension;
 - In any other case 1/2 of the commuted value of such pension;
- c. Received from a pension fund (JeevanSuraksha) set up by Life Insurance Corporation under Section 10 (23AAB). [Sec. 10(10A)]

11(B) Leave salary: Any payment received by an employee of central Vs State Govt. as the cash equivalent of the leave salary in respect of the period of earned leave at his credit at the time of his retirement whether on superannuation or otherwise. But in case of other employees the exemption is available subject to limits prescribed. [Sec. 10 (10AA)]

11(C)Retrenchment compensation: The amount of any compensation received by a workman under Industrial Disputes Act or under any other act or rules, order or notification issued there under or under any standing order or under any award, contract of service or otherwise at the time of his retrenchment is exempt subject to the extent such compensation is in accordance with Section 25F (b) of Industrial Disputes Act or Rs. 5, 00,000 (w.e.f. 1.1.1997) whichever is less.

Also, the compensation paid under any scheme approved by the Central Government is fully exempt without any limit. [Sec. 10 (10B)]

11(D) Compensation received by victims of Bhopal Gas Leak Disaster (Processing of Claims) Act, 1985 any scheme framed there under. [Sec. 10 (10BB)]

11(E)Voluntary Retirement compensation received at the time of retirement from a public limited company: Any payment received by an employee of public sector company or any other company or any authority established under a Central, State or Provincial Act, or a local authority, or a co-operative society or a University (including an institution declared to be a University) or an Indian Institute of Technology or a notified institute of management at the time of his voluntary retirement (or termination of service) in accordance with any (approved) scheme (or a scheme of voluntary separation in case of a public sector company.).

From assessment year 2004-05 and onwards, any amount received or receivable (i.e. in installment) by such employee on his (as against at the time of his) voluntary retirement under VRS is exempt subject to limit of Rs. 5, 00,000. [Sec. 10 (10C)]

11(F)Sum received from Life Insurance Policy:Any sum received under a life insurance policy, including any bonus allocated on such policy but excluding sums received under a policy referred to in section 80DDA or under a Keyman Insurance Policy on the life of any former or present employee or any person connected with the business.

Under Finance Act, 2003 Section 10 (10D) is substituted as follows:

Under substituted section 10 (10D), exemption is not available in respect of any sum received: (1) under Sec. 80 DD (3) and 80 DDA (3), (2) under a keyman insurance policy and (3) under an insurance policy issued on or after 1-4-2003 in respect of which premium payable for any of the year during the term of policy exceeds 20% of actual capital sum assured.

However, in respect of policy referred to in (3), any sum received on death of a person is exempt. Calculation of actual capital sum assured is to be made in accordance with Explanation to Section 88 (2A). [Sec. 10 (10D)]

12. Payment from Provident Fund - Any payment (including interest from a provident fund) under Provident Fund Act, 1925 or Public Provident Fund Scheme, 1968 or such other funds set up by Government of India. [Sec. 10(11)3

13. Accumulated Balance of Recognized Provident Fund -Any accumulated balance due and becoming payable to an employee from a recognized provident fund, if any of the following conditions are satisfied -

- a. If he has rendered a continuous service of more than five years, or
- b. If his service, though not continuous, has been terminated due to his ill-health or by the contraction or discontinuation of his employer's business or any other cause beyond his control, or
- c. If on cessation of his employment, his accumulated balance is transferred to recognized provident fund. [Sec. 10(12)]

14. Payment from an approved Superannuation fund -Any payment from an approved superannuation fund is made (i) on the death of abeneficiary, or (ii) to an employee in lieu of or in commutation of an annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement, or (iii) by way of refund of contributions on the death of abeneficiary, or (iv) by way of refund of contributions to an employee on his leaving the service otherwise than by retirement at or after a specified age or on his becoming incapacitated prior to such retirement, to the extent of contributions made prior to

1.4.1962 and any interest thereon. [Sec. 10 (13)]

14(A)House Rent Allowance: Any special allowance to an assessee by his employer to meet expenditure incurred on payment of rent for accommodation. The exemption is not available, in case the residential accommodation occupied by the assessee, is owned by him or the assessee has not actually incurred expenditure on payment of rent in respect of the accommodation occupied by him. [Sec. 10 (13A)]

15. Special allowance: Any special allowance or benefit as may be prescribed which is not in nature of perquisites, specially granted to meet expenses

wholly in performance of duties to the extent such expenses are actually incurred for that purpose. .

Allowance for meeting personal expenses or compensating increased cost of living as may be prescribed and to the extent so prescribed. [Sec. 10 (14)]

15(a)Any Income received by a public financial institution as exchange risk premium from any person borrowing foreign currency.[Sec. 10 (14A)]

- 16. Interest on securities:** Income by way of interest, premium on redemption or other payment, on notified securities, bonds annuity certificates, saving certificates, other certificates and deposits. [Sec. 10 (15) (i)]

16(a)Interest on Capital Investment Bonds having simple interest @ 7% p.a. payable annually, without any limit on investment held by individual or Hindu Undivided Family. [Sec. 10(15) (ii) (b)]

16(b)Relief Bonds : Interest on notified Relief Bonds carrying 9% interest w.e.f 1.1.1999 (10% up to 31.12.1998) in case of an individual or an H.U.F. [Sec. 10 (15) (ii) (c)]

16(c)Interest on notified bonds, NRI Bonds 1988 of State Bank of India and NRI Bonds Second Series issued by State Bank of India, also called as India Development Bonds arising to non-resident Indian or his nominee or survivor or the person to whom such bonds have been gifted by a non-resident, provided the bonds are purchased in foreign exchange and the principal and interest thereon, are not allowable to be taken out of India.

No such bonds will be notified by the Central Government on or after 1-6-2002. As such exemption will be restricted to interest on such bonds which are notified up to 31-5-2002.[Sec. 10 (15) (ii) (d)]

16(d)Interest payable to any foreign bank by any scheduled bank shall be exempt, provided such deposits are made with the approval of Reserve Bank of India.[Sec. 10 (15) (in) (a)]

16(e)Interest on money borrowed by IFCI, IDBI, Exim Bank, National Housing Bank, SIDBI or ICICI from sources outside India is exempt to the extent it does not exceed the amount of interest at the rate approved by the Central Government. [Sec. 10 (15) (iv) (d)]

16(f) Interest payable by an Industrial Undertaking in India on a foreign currency loan borrowed from sources outside India and approved by the Central Government. [Sec. 10(15) (iv) (f)]

16(g) Interest payable by Scheduled Banks to a non-resident person or a not ordinarily individual/HUF on foreign currency deposits approved by the Reserve Bank of India. [Sec. 10 (15) (iv) (fa)]

16(h) Interest payable on foreign currency loans by a Public Company providing long-term housing finance for construction or purchase of residential houses in India and eligible for deduction under Sec. 36 (1) (viii),

The exemption is restricted to loan agreement which is approved by the Central Govt. on or before 31-5-2003. In respect of agreement approved on or after 1-6-2003, exemption is not available from assessment year 2004-05 and onwards. [Sec. 10 (15)(iv) (g)]

16(i) Interest payable on specified Public Sector Companies' bonds. [Sec. 10 (15) (iv) (h)]

16(j) Interest on Retirement Benefits deposited by an employee of the Central or State Govt. or a Public Sector Company under Deposit Scheme for Retiring Govt. Employees, 1989 and Deposit Scheme for Retiring Employees of Public Sector Companies, 1991.

[Sec. 10 (15) (iv) (i)]

16(k) Interest on Securities/Deposits held by the Welfare Commissioner, Bhopal Gas Victims, Bhopal out of compensation for Bhopal Gas Tragedy for the benefit of such victims. [Sec. 10 (15) (v)]

16(l) Interest on Gold Deposit Bonds, 1999. [Sec. 10 (15) (vi)]

16(m) Interest on notified bonds issued by a local authority. [Sec. 10 (15) (vii)]

16(n) Any payment made by an Indian Company engaged in the business of operation of aircraft to acquire an aircraft or an aircraft engine (other than a payment for providing spares, facilities or services in connection with the operation of leased aircraft) on lease from the Government of a foreign State or a foreign enterprise under an agreement entered before 1.4.1997 or after 31.3.1999 and approved by the Central Government. However w.e.f.1-4-2006 (A.Y. 2006-07 and onwards)

according to Section 10 (15A) no exemption will be allowed in respect of all such agreements entered into on or after 1-4-2005. [Sec. 10 (15A)]

17. Educational Scholarships granted to meet the cost of education, [Sec. 10 (16)]

18. **Daily Allowances of Members of Parliament.**

a. Any daily allowance received by Members of Parliament or any State Legislature.

b. Any allowance received by any member of Parliament under the Members of Parliament. (Constituency Allowance) Rules, 1986.

c. All other allowances upto Rs. 2,000 p.m., in the aggregate received by member of any

State Legislature or any committee thereof. [Sec. 10 (17)]

18(a) Any amount in connection with the award (in cash or in kind) instituted in the public interest by Central/State Government or approved by the Central Government or as rewards by the Central/State Government for approved purposes. [Sec. 10 (17A)]

19. **Pension to gallantry award winners:** Pension/Family Pension received by a Central or State Government employee who has been awarded ParamVir Chakra / MahaVir Chakra / Vir Chakra / other notified gallantry award, or by his family. [Sec. 10(18)]

From 1-4-2005 {A.Y. 2005-06 and onwards) Section 10(19) provides for exemption of family pension received by the widow or children or nominated heirs of a member of armed forces of the union, where the said member dies in the case of operational duties, in such circumstances and conditions, as may be proscribed.

20. **Former rulers of Indian states:** Annual value of a palace in the occupation of an ex-ruler. [Sec. 10 (19A)]

21. Income of local authority. [Sec. 10(20)]

21(a) Income of a housing and town planning authority. [Sec. 10 (2A)]

22. **Income of approved scientific and research association** applying its income wholly and exclusively to its objects, including profits and gains of a business carried on by the institution which is incidental to its objects. [Sec. 10 (21)]

23. Income of specified News Agency set up in India, which applies its income or accumulates it for application solely for collection and distribution of news and does not distribute its income in any manner to its members. [Sec. 10 (22B)]

24. Income of professional Institutions engaged in promotion etc. of notified sports.

The exemption has been withdrawn and will not be available from assessment year 2003-04 and onwards. [Sec. 10 (23)]

24(a) Income received on behalf of regimental fund or non-public fund established by the armed forces for the welfare of the past and present members of the force or their dependents. [Sec. 10 (23AA)]

24(b) Income received by an approved fund for the welfare of employees or their dependents of which such employees are the members and which applies its income or accumulates it for application, wholly and exclusively, to the objects for which it is established and invests its funds in the forms or modes specified under Sec. 11 (5).

[Sec. 10 (23AAA)]

24(c) Exemption to income of pension fund: Income of a pension fund (namely Jeevan Suraksha) set up by the Life Insurance Corporation of India. [Sec. 10 (23AAB)]

24(d) Income of a Public Charitable Trust, registered society etc. engaged in development of khadi and village industries without profit motive. [Sec. 10(23B)]

24(e) Income of Khadi and Village Board established for the development of Khadi and Village Industries. [Sec. 10 (23BB)]

24(f) Income of statutory bodies for the administration of public charitable trusts: Any income of any authority approved by the Central or State or Provincial Govt. for the administration of any public, religious or charitable trust or endowments (including maths, temples, gurudwaras, wakfs, churches, synagogues, ajiaries or other places of public religious worship) registered under the Societies Registration Act, 1860, or any other law for the time being in force. [Sec. 10 (23 BBA)]

24(g) Income of the European Economic Community derived in India by way of interest, dividends or capital gains from investments made out of its funds under specified scheme. [Sec. 10 (23 BBB)]

24(h)Income of the SAARC Fund for Regional Projects.[Sec. 10 (23BBC)] **24(i)Income of the Secretariat of Asian Organisation of Supreme Audit Institutions:**

Income of the Secretariat of the Asian Organisation of the Supreme Audit Institutions which has been registered as ASOSAI-SECRETARIAT under the Societies Registration Act, 1860 will be exempt for the assessment years 2001-02, 2002-03 and 2003-04. According to the amendment made in Finance Act, 2003, this exemption has been extended to further 4 years i.e. upto assessment year 2007-08. [Sec. 10 (23 BED)]

24(j)Income of Insurance Regulatory Authority: Income of Insurance Regulatory and Development Authority will be exempt from tax from the assessment year 2001-03.[Sec. 10 (23 BBEJ)]

24(k)Income of P.M. Relief Fund or any approved fund/National Fund: Amount of donation received by fund/institution which has been utilized for purposes other than providing relief to the victims of earthquakes in Gujarat or which remains unutilized as per Section 80 C (5C) and not transferred to the P.M. National Relief Fund or on before 31-3-2003, shall be deemed to be income of previous year and charged to tax. [Sec. 10 (23C)]

The said date of 31-3-2003 has been extended to 31-3-2004 as per amendment under Sec. 6 (6) of the Finance Act, 2003.

24(l)Income received by the National Foundation for Communal Harmony.

[Sec. 10 (23C) (iii) (a)]

24(m)Income of Educational Institutions : Income of a University/educational institution, hospital or medical institution wholly or substantially financed by the Govt., or the annual receipts of which do not exceed the prescribed amount or which is approved by the prescribed authority. [Sec. 10 (23 C) (iii ab), (iii ac), (iii ad), (iii ae), (vi) (via)]

24(n)Income of notified fund, charitable/religious institution or trust which applies its income wholly and exclusively in pursuance of its objects. [Sees. 10 (23C) (iv) and (v)]

24(o)Income of Mutual Fund registered with SEBI, or set up by a public sector bank or a public financial institution, or authorised by the Reserve Bank of India subject to notified conditions. Income distributed by

a Mutual Fund to its unit holders shall be subject to additional income-tax @ 10% under Sec.11 SR.

Under the amendment, from assessment year 2004-05 and onwards, the income of notified Mutual Fund registered with SEBI is exempt, subject to conditions and where such fund is required to pay tax on income distributed to its unit holders under Sec. 115 R (2) of Chapter XII-E. This amendment is consequential to exemption of income distributed by Mutual Fund under Sec. 10 (35) from the said assessment year. [Sec. 10 (23D)]

24(p)Income of notified Exchange Risk Administration Fund. [Sec. 10 (23E)]

24(q)Income of notified Investor Protection Fund set up by recognized stock exchanges in India. [Sec. 10 (23EA)]

24(r) Income of Credit Guarantee Funds Trust for Small Scale Industries: A new clause 23 (EB) has been inserted in Section 10, It provides exemption to any income of the Credit Guarantee Fund Trust for Small Scale Industries being a trust created by the Govt. of India and the Small Industries Development Bank of India for assessment years 2002-03 to 2006-07. Under the amendment the word substituted as “Credit Guarantee Fund Trust for Small Industries’ [Sec. 23 (EB)]

24(s)Income of an approved Venture Capital Fund or Venture Capital Company by way of dividends or long-term capital gains on equity shares in a venture capital undertaking held for more than three years provided the investment has been made before 31.3.1999.[Sec.10 (23F)]

24(t)Income of an approved Venture Capital Fund or Venture Capital Company by way of dividends (not subjected to dividend tax under Sec. 115-0) or long-term capital gains on equity shares in a venture capital undertaking [in respect of investments made upto 31.3.2000] , [Sec. 10 (23FA)]

24(u)Income of a Venture Capital Company or Venture Capital Fund set up to raise funds for investment in a venture capital undertaking. [Sec. 10(23FB)]

24(v)Income by way of dividends, interest, or long-term capital gains of an infrastructure capital fund/company from investments made on or after 1.6.1998 by way of shares or long-term finance in any approved enterprise carrying on the business of [(i) developing, or (ii) maintaining and

operating, or (iii) developing, maintaining and operating any infrastructure facility. [Sec. 10 (23G)]

25. Income of Trade Union or association of Trade unions from house property and income from other sources. [Sec. 10 (24)]

26. **Income of statutory provident fund** under Provident Fund Act, 1925, or recognized provident fund or an approved superannuation fund or approved gratuity fund etc.[Sec. 10 (25)]

26(a) Income of the Employees' State Insurance Fund set up under the ESI Act, 1948. [Sec. 10 (25A)]

27. **Income of members of scheduled tribes** residing in specified areas. [Sec. 10 (26)]

27(a) Income of a statutory corporation body, association or institution formed or established for promoting the interests of the members of Scheduled Castes or Scheduled Tribes or backward classes or of any two or all of them. [Sec. 10 (26B)]

27(b) Income of a Corporation established by the Central/State Government for promoting the interests of a notified **minority community**, [i.e. Muslims, Christians, Sikhs, Buddhists and Zoroastrians (Parsis)] [Sec. 10 (26BB)]

27(c) Any Income of a corporation established by a Central, State or Provincial Act for the welfare and economic upliftment of ex-servicemen being the citizens of India is exempt from assessment year 2004-05 and onwards. [Sec. 10 (26 BBB)]

28. **Income of a Co-operative Society** formed for promoting the interest of members of either the Scheduled Caste or Scheduled Tribes. [Sec. 10 (27)]

29. **Income of authorities constituted for marketing of commodities** from letting of godowns or warehouse for facilitating marketing of commodities. [Sec. 10(29)]

30. **Subsidy received from Tea Board** for replantation or replacement of teabushes or for rejuvenation or consolidation of areas used for cultivation of tea under any scheme notified by the Central Government. [Sec. 10 (30)]

30(A) Income accruing or arising to the Coffee Board, Rubber Board, Tea Board, Tobacco Board, Marine Products Export Development

Authority, Agricultural and Processed Food Products Export Development Authority and Spices Board. [Sec. 10 (29A)]

- 31. Subsidy received from** the Rubber Board, Coffee Board, Spices Board or any other Board under any scheme of replanting or replacement etc. [Sec. 10(31)]
- 32. Income of minor** child liable to be included in income of his parent u/s 64 (1A) upto a maximum of Rs. 1,500 per minor child. [Sec. 10(32)]
- 33. Dividend income and interest from UTI/Mutual fund:**
- a. Dividends distributed by a domestic company and subjected to additional income-tax under Sec. 115-0.
 - b. Income in respect of units of the Unit Trust of India.
 - c. Income in respect of units of Mutual Fund specified under Sec. 10 (23D). [Sec. 10 (33)] Sec. 10 (33) is amended as per Sec. 6 (1) of the Finance Act, 2003 as follows: Any income (i.e. capital gains) arising from the transfer of a unit of the Unit Scheme, 1964 referred to in Schedule 1 to the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 is exempt under Sec. 10 (33) from assessment year 2003-04 and onwards. Consequently loss arising on transfer (sale) of such unit cannot be set off against capital gains in respect of other assets.
- 34. Income of Dividend declared, distributed or paid :** Any income by way of dividends referred to in Sec. 115-0 declared, distributed or paid by a domestic company on or after 1-4-2003 is exempt from assessment year 2004-05 and onwards. [Sec. 10 (34)]
- 35. Income by way units of a Mutual Fund:** Any income by way of income received in respect of units (a) of a Mutual Fund specified in Sec. 10 (23D), (b) from the Administrator of the specified undertaking and (c) from the specified company, is exempt from assessment year 2004-05 and onwards. However, any income arising on transfer (sale) of such units by the unit holder will not be exempt under Sec. 10 (35). [Sec. 10 (35)]
- 36. Long-term capital gains arising on transfer (sale) of eligible equity shares:** Long-term capital gains arising on transfer (sale) of eligible equity share in a company purchased - on or after 1-3-2003 and before 1-3-2004 and held for a period of 12 months or more is exempt from assessment year

2004-05 and onwards. 'Eligible equity share' is defined to mean any equity share in a company:

- a. Being a constituent of BSE-50Q index of the Stock Exchange, Mumbai as on 1-3-2003 and the transactions of purchase and sale of such equity share are entered into on a recognized stock exchange in India;
- b. Allotted through a public issue on or after 1-3-2003 and listed in a recognized stock exchange in India before 1-3-2004 and the transaction of sale of such share is entered into on a recognized stock exchange in India. [Sec. 10 (36)]

37. Capital gain on compulsory acquisition of urban agricultural land (Section 10(37)): In the case of an individual/HUF capital gain arising on transfer by way of compulsory acquisition of urban agricultural land is not chargeable to tax from the A.Y. 2005-06 if such compensation is received after 31st March, 2004 and the agricultural land was used by the assessee (or by any of his person) for agricultural purposes during 2 years immediately prior to transfer.

38. Long-term capital gain on transfer of equity shares/units in cases covered by securities transaction tax (Section 10(38)): From 1-4-2005 (A.Y. 2005-06 and onwards) newly inserted Section 10(38) provides that any income arising from the transfer of a long-term asset being an equity share in a company or a unit of an equity oriented fund is exempt where the transaction of sale of such equity share or unit is entered into on or after the date on which the STT (Securities Transaction Tax) comes into force and such transaction is chargeable to STT under Chapter VII of the Finance Act, 2004.

The STT is applicable if equity shares or units of equity oriented fund are transferred on or after 1-10-2004 in a recognized stock exchange in India (or units are transferred to the mutual fund). If the securities transaction tax is applicable long-term capital gain is not chargeable to tax short-term capital gain is taxable @ 15% (plus S.C. and E.G.). If income is shown as business income, the taxpayer can claim rebate under Section 88E.

39. Income from any international sporting event (Section 10(39)): Income arising from a notified international sporting event is exempt from tax from the A.Y. 2006-07 if such event is approved by the international body and has participation by more than two countries.

40. Grant received by subsidiary company from the holding company (Section 10(40)): In the case of reconstruction or revival of an existing business of power generation by way of transfer of business to an Indian Co., if any grant (or otherwise) is received by a Subsidiary Co. from its Indian company, it is not chargeable to tax from A.Y. 2006-07.

Any long-term, short-term capital gain arising from the above mentioned arrangement is not chargeable to tax if the transfer takes place before 1st April, 2006.

Check your progress 9

1. Maximum limit of exemption of gratuity is _____.
 - a. 350000
 - b. 500000
 - c. 100000

3.11 Let Us Sum Up

In this unit we have studied basic things about income tax of India. We have studied that the word implies is a tax on “income”. Therefore, one has to know as to what is income which is chargeable to income-tax. In general, the term income means any monetary gain either in the form of money or money’s worth coming from a certain source with some sort of regularity.

Income is the return on capital but capital is not necessarily a source of income in all cases. The term ‘income’ is of such a wide importance that it is very difficult, perhaps impossible, to define precisely. In a leading case Kamakhya Narayan Singh V/s. Commissioner of Income Tax, the learned judges had remarked, - ‘the word income’ is of the broadest connotation, it is a word difficult and perhaps impossible to define’. The Indian Income Tax Act does not provide any definition of the term ‘income’. It only gives a list of sources of income and prescribes methods of computation of income under various heads of income, (e.g. Income from salary, house property, business etc.). The Act specifies the items which are included in income and, thus, items which do not appear in the list escape the tax net.

The aim of this unit was to discuss the basic things of income tax with the readers. An introduction of basic concepts is very necessary especially in a subject like income tax.

3.12 Answer for Check Your Progress

Check your progress 1

Answers: (1-a)

Check your progress 2

Answers: (1-b)

Check your progress 3

Answers: (1-a)

Check your progress 4

Answers: (1-b)

Check your progress 5

Answers: (1-a)

Check your progress 6

Answers: (1-b)

Check your progress 7

Answers: (1-a)

Check your progress 8

Answers: (1-b)

Check your progress 9

Answers: (1-a)

3.13 Glossary

1. **Global Income Tax** - Income tax that aggregate income from all sources at the individual (or family unit) level. The income is then taxed at a single progressive rate.
2. **Sole Proprietorship** - Ownership of all of the assets of an unincorporated business by a single individual. The individual owner is personally liable for all debts of the business

3.14 Assignment

Describe the Hindu Undivided Family.

3.15 Activities

What is meant by Agricultural Income? Explain in detail

3.16 Case Study

Browse through the Internet and make a list of definition of Income and Person.

3.17 Further Readings

1. Direct Taxes, Gupta and Ahuja
2. The Economics of Taxation, Bernard Salanié, MIT Press, 1997
3. The Economics of Taxation, Henry Aaron and Michael J. Boskan, The Brookings Institution, 1980
4. Taxation: Its Principles and Methods, Luigi Cossa

Block Summary

In this block we have learnt that taxation is one of the most important factor responsible for the growth and development of our economy. Income tax is considered to be one of the most complicated acts in India. Most of the time students have been found running away from this subject. Best efforts have been made to explain the topics in very easy language and in most interesting ways. Sufficient illustrations and pictures have been added to make the content more interesting and easy understandable.

The whole block was divided into three units and the first unit covers the basics concepts and gives an overview of the subject Income tax act 1961. It covers meaning and definition of Taxation, characteristics of Taxation, types of Taxes, direct Taxes, indirect Taxes. Unit second gives the scope and objectives of income tax .It covers background of Income Tax, Scope of Income Tax Law, Application of Income Tax Act, 1961, Objectives of Income Tax, Taxation Structure in India. Whereas the last unit covers Basics of income and person .It covers the topic Concept of Income, Definition of Income, Person, Assessee, Assessment Year, Agricultural Income, Residential Status, Companies, Incomes Exempted from Tax.

This block is going to be of great help for all the readers who intend to build the career in this respective line.

Block Assignment

Short Answer Questions

1. Meaning and definition of taxation.
2. Characteristics of taxation.
3. Additional canons of taxation advocated by other experts.
4. Observations on Indian Tax Structure.
5. Application of Income Tax Act, 1961.
6. Excise duty.
7. Wealth-tax.
8. Incomes exempted from Tax.
9. Companies.
10. Assessment Year.
11. Artificial Judicial Persons.
12. Concept of Income.

Long Answer Questions

1. Discuss the various types of taxes.
2. Write a note on tax structure in India.
3. Discuss the various types of status in case of Income tax of India.

Enrolment No.

1. How many hours did you need for studying the units?

Unit No	1	2	3	4
Nos of Hrs				

2. Please give your reactions to the following items based on your reading of the block:

Items	Excellent	Very Good	Good	Poor	Give specific example if any
Presentation Quality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____ _____
Language and Style	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____ _____
Illustration used (Diagram, tables etc)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____ _____
Conceptual Clarity	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____ _____
Check your progress Quest	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____ _____
Feed back to CYP Question	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____ _____

3. Any Other Comments

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“

*Education is something
which ought to be
brought within
the reach of every one.*

”

- Dr. B. R. Ambedkar



Dr. Babasaheb Ambedkar Open University
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TAXATION FOR MANAGERS

PGDF-204

BLOCK 2: HEADS OF INCOME

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TAXATION FOR MANAGERS



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ROLE OF SELF INSTRUCTIONAL MATERIAL IN DISTANCE LEARNING

The need to plan effective instruction is imperative for a successful distance teaching repertoire. This is due to the fact that the instructional designer, the tutor, the author (s) and the student are often separated by distance and may never meet in person. This is an increasingly common scenario in distance education instruction. As much as possible, teaching by distance should stimulate the student's intellectual involvement and contain all the necessary learning instructional activities that are capable of guiding the student through the course objectives. Therefore, the course / self-instructional material are completely equipped with everything that the syllabus prescribes.

To ensure effective instruction, a number of instructional design ideas are used and these help students to acquire knowledge, intellectual skills, motor skills and necessary attitudinal changes. In this respect, students' assessment and course evaluation are incorporated in the text.

The nature of instructional activities used in distance education self-instructional materials depends on the domain of learning that they reinforce in the text, that is, the cognitive, psychomotor and affective. These are further interpreted in the acquisition of knowledge, intellectual skills and motor skills. Students may be encouraged to gain, apply and communicate (orally or in writing) the knowledge acquired. Intellectual-skills objectives may be met by designing instructions that make use of students' prior knowledge and experiences in the discourse as the foundation on which newly acquired knowledge is built.

The provision of exercises in the form of assignments, projects and tutorial feedback is necessary. Instructional activities that teach motor skills need to be graphically demonstrated and the correct practices provided during tutorials. Instructional activities for inculcating change in attitude and behavior should create interest and demonstrate need and benefits gained by adopting the required change. Information on the adoption and procedures for practice of new attitudes may then be introduced.

Teaching and learning at a distance eliminates interactive communication cues, such as pauses, intonation and gestures, associated with the face-to-face method of teaching. This is particularly so with the exclusive use of print media. Instructional activities built into the instructional repertoire provide this missing interaction between the student and the teacher. Therefore, the use of instructional activities to affect better distance teaching is not optional, but mandatory.

Our team of successful writers and authors has tried to reduce this.

Divide and to bring this Self Instructional Material as the best teaching and communication tool. Instructional activities are varied in order to assess the different facets of the domains of learning.

Distance education teaching repertoire involves extensive use of self-instructional materials, be they print or otherwise. These materials are designed to achieve certain pre-determined learning outcomes, namely goals and objectives that are contained in an instructional plan. Since the teaching process is affected over a distance, there is need to ensure that students actively participate in their learning by performing specific tasks that help them to understand the relevant concepts. Therefore, a set of exercises is built into the teaching repertoire in order to link what students and tutors do in the framework of the course outline. These could be in the form of students' assignments, a research project or a science practical exercise. Examples of instructional activities in distance education are too numerous to list. Instructional activities, when used in this context, help to motivate students, guide and measure students' performance (continuous assessment)



PREFACE

We have put in lots of hard work to make this book as user-friendly as possible, but we have not sacrificed quality. Experts were involved in preparing the materials. However, concepts are explained in easy language for you. We have included many tables and examples for easy understanding.

We sincerely hope this book will help you in every way you expect.

All the best for your studies from our team!



TAXATION FOR MANAGERS

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TAXATION FOR MANAGERS

BLOCK 2: HEADS OF INCOME

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HEADS OF INCOME BUSINESS OR PROFESSION
AND HOUSE PROPERTY

03

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UNIT 3

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BLOCK 2: HEADS OF INCOME

Block Introduction

As discussed in the earlier block the importance of income tax. This act is considered to be one of the most important act and the most complicated too.

As already discussed the complexity of Income Tax. The writer has tried his best to explain the topics in very easy language and in most interesting ways. Sufficient illustrations and pictures have been added to make the content more interesting and easy understandable. Unit first discusses about the heads of income business or profession and house property. Here detailed discussion has been made on Income from Business or Profession, General Principles governing the computation of taxable income under the head “profits and gains of business or profession, Expenses allowed as deduction from Profit and Gain of Business or Profession and Expenses Expressly Disallowed (u/s40). On the other hand unit second focuses on capital gains. Here detailed discussion has been made on basis of Charge (Sec 45), Chargeability of Tax, differences between the long as well as short term capital gain has also been discussed here in detail. how is capital gain charged , are there any special rates for it chargeability has been discussed here in detail. Lastly the unit third discusses about the head of Income from other sources, here discussion has been made on Income from other sources (Sec 56), Sufficient problems have been provided with the solution to help the student in understanding the concepts of income tax more thoroughly.

So after going through this block you will have sufficient knowledge of calculating income and income tax.

Block Objective

After learning this block, you will be able to understand:

- Much about business or profession.
- Calculate profits and gains of business or profession.
- Identify expenses allowed as deduction from profit and gain of business or profession.
- Section 40 which speaks about disallowed expenses.
- Various types of capital gains.

Heads of
Income

- Role of cost inflation index and rates for the various financial years.
- Income from other sources u/s 56.
- How to calculate taxes on other sources income.

Block Structure

Unit 1: Heads of Income Business or Profession and House Property

Unit 2: Heads of Income under Capital Gains

Unit 3: Heads of Income-Other Sources

UNIT 1: HEADS OF INCOME BUSINESS OR PROFESSION AND HOUSE PROPERTY

Unit Structure

- 1.0 Learning Objectives**
- 1.1 Introduction**
- 1.2 Income from Business or Profession**
- 1.3 General Principles Governing the Computation of Taxable Income under the Head “Profits and Gains of Business or Profession**
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- 1.5 Income Chargeable under the Head Business / Profession**
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- 1.11 Glossary**
- 1.12 Assignment**
- 1.13 Activities**
- 1.14 Case Study**
- 1.15 Further Readings**

1.0 Learning Objectives

After learning this unit, you will be able to understand:

- Define income from business or profession.
- Delineate the income from profits and gains of business or profession.
- Explain the meaning of income chargeable under the head business/profession.
- Identify expenses allowed as deduction from profit and gain of business or profession.
- Describe Expenses Expressly Disallowed (u/s40).

1.1 Introduction

Under the Income Tax Act, 'Profits and Gains of Business or Profession' are also subjected to taxation. The term "business" includes any (a) trade, (b) commerce, (c) manufacture, or (d) any adventure or concern in the nature of trade, commerce or manufacture. The term "profession" implies professed attainments in special knowledge as distinguished from mere skill; "special knowledge" which is "to be acquired only after patient study and application". The words 'profits and gains' are defined as the surplus by which the receipts from the business or profession exceed the expenditure necessary for the purpose of earning those receipts. These words should be understood to include losses also, so that in one sense 'profit and gains' represent plus income while 'losses' represent minus income.

1.2 Income from Business or Profession

The following types of income are chargeable to tax under the heads profits and gains of business or profession:-

- Profits and gains of any business or profession
- Any compensation or other payments due to or received by any person specified in section 28 of the Act
- Income derived by a trade, profession or similar association from specific services performed for its members

- Profit on sale of import entitlement licences, incentives by way of cash compensatory support and drawback of duty;
- The value of any benefit or perquisite, whether converted into money or not, arising from business
- Any interest, salary, bonus, commission, or remuneration received by a partner of a firm, from such a firm
- Any sum whether received or receivable in cash or kind, under an agreement for not carrying out any activity in relation to any business or not to share any know-how, patent, copyright, franchise, or any other business or commercial right of similar nature or technique likely to assist in the manufacture or processing of good
- Any sum received under a keyman insurance policy
- Income from speculative transactions

In the following cases, income from trading or business is not taxable under the head “profits and gains of business or profession”:

- Rent of house property is taxable under the head “Income from house property”. Even if the property constitutes stock in trade of recipient of rent or the recipient of rent is engaged in the business of letting properties on rent.
- Deemed dividends on shares are taxable under the head “Income from other sources”.
- Winnings from lotteries, races etc. are taxable under the head “Income from other sources”.

Profits and gains of any other business are taxable, unless such profits are subjected to exemption.

Check your progress 1

1. Winnings from lotteries, races etc. are taxable under the head _____.
 - a. Income from business and profession
 - b. Income from other sources

1.3 General Principals Governing the Computation of Taxable Income under the Head “Profits and Gains of Business or Profession

- Business or profession should be carried on by the assessee. It is not the ownership of business which is important, but it is the person carrying on a business or profession, who is chargeable to tax.
- Income from business or profession is chargeable to tax under this head only if the business or profession is carried on by the assessee at any time during the previous year. This income is taxable during the following assessment year.
- Profits and gains of different business or profession carried on by the assessee are not separately chargeable to tax i.e. tax incidence arises on aggregate income from all businesses or professions carried on by the assessee. But, profits and loss of a speculative business are kept separately.
- It is not only the legal ownership but also the beneficial ownership that has to be considered.
- Profits made by an assessee in winding up of a business or profession are not taxable, as no business is carried on in that case. However, such profits may be taxable as capital gains or as business income, if the process of winding up is such as to involve the carrying on of a trade.
- Taxable profit is the profit accrued or arising in the accounting year. Anticipated or potential profits or losses, which may occur in future, are not considered for arriving at taxable income. Also, the profits, which are taxable, are the real profits and not notional profits. Real profits from the commercial point of view mean a gain to the person carrying on the business and not profits from narrow, technical or legalistic point of view.
- The yield of income by a commercial asset is the profit of the business irrespective of the manner in which that asset is exploited by the owner of the business.
- Any sum recovered by the assessee during the previous year, in respect of an amount or expenditure which was earlier allowed as deduction, is taxable as business income of the year in which it is recovered.

- Modes of book entries are generally not determinative of the question whether the assessee has earned any profit or loss.
- The Income tax act is not concerned with the legality or illegality of business or profession. Hence, income of illegal business or profession is not exempt from tax.

The provisions regarding income chargeable under the head 'Profits and Gains of Business or Profession' are contained in section 28 to 44D of the Income Tax Act, 1961.

Business: (Sec 2(13)) Profession means the purchase and sale or manufacture of a commodity with a view to make profit. It includes any trade, commerce or manufacture or any adventure or concern in the nature of trade. It is important that the intention of purchase or manufacture should be to sell at a profit.

Profession: (Sec 2(36)) Profession means the activities for earning livelihood which require intellectual skill, e.g. the work of a lawyer, doctor, auditor, engineer and so on, are in the nature of profession.

Vocation: Vocation means activities which are performed in order to earn livelihood, e.g. brokerage, insurance agency, music, dancing etc. The rules for the assessment of business, profession or vocation are same.

Check your progress 2

1. _____ means activities which are performed in order to earn livelihood, e.g. brokerage, insurance agency, music, dancing etc.
 - a. Vocation
 - b. Business
 - c. Profession

1.4 Income from Profits and Gains of Business or Profession

Given below are few FAQ's related to income from profits and gains of business or profession?

1. In case of a working partner of a firm receiving salary as per the partnership deed, in computation of his individual income, will such salary be taxed under the head salaries?

No. In such a case the salary will be taxed under the head "Profits & Gains from business or Profession"

2. In the above case can the assessee claim standard deduction?

Since the income is not charged under the head salaries, standard deduction cannot be claimed.

3. Does the frequency or number of transactions affect the taxability of an entity?

No. Even an isolated transaction may be considered as business given the facts and circumstances of the case.

4. Are losses to business such as theft, embezzlement etc., allowed as a deduction in computing business income?

Yes. They are allowed on grounds of commercial expediency and not covered by any specific provision of the act.

5. Can the benefit of carry forward of Depreciation allowance be claimed where the actual business in respect of such depreciation has been discontinued?

Yes, the benefit can be claimed even when the original business is discontinued.

6. Subject to the exceptions specified in the Income Tax Act, where cash payments exceeding 20000 are made, what is the tax implication?

Any payment in excess of Rs. 20,000 shall not be allowed as a deduction while computing income under the head "Profits and gains of business or profession" in terms of Section 40A (3).

7. Are income tax and wealth tax deductible expenses?

No. They are not deductible expenses.

8. Is provision made for gratuity an allowable expense?
Provision made for the purpose of payment of sums by way of any contribution towards an approved gratuity fund or for the purpose of payment of any gratuity that has become payable during the previous year is eligible for deduction under section 40A(7).

9. Is interest on loan taken for payment of income tax a deductible expense?
No. It is not an expenditure incurred wholly and exclusively for the purpose of business. Therefore it is not a deductible expense.

10. The Director of a company was accompanied by his wife on a foreign tour undertaken by him for business purposes. Is the travel expenditure of the wife an allowable expense?
The travel expenditure of the spouse can be said to be admissible where it is necessary for promotion of business on grounds commercial expediency. Otherwise it is inadmissible.

11. For how many years can the tax credit in respect of MAT (Minimum Alternative Tax) be carried forward by the company?
sevenassessment years.

12. Against what is the tax credit in respect of MAT adjusted?
With the insertion of section 115JB no tax credit is available now.

13. Does periodicity of payment affect the nature of income to determine whether it is a capital or revenue expenditure?
No. It does not matter if the payment is made periodically or as a lump sum amount.

14. Can the method of charging depreciation be changed in an accounting year?
For accounting purposes, depreciation should be charged consistently. But it can be changed under the following circumstances:
If the new method is required by any statute.
If it is necessary for compliance with any accounting standard.
If the change would result in a more appropriate preparation of financial statements.

15. What is the distinction between a reserve and a provision?

Heads of
Income

A provision is usually made against anticipated losses and contingencies and is charged against the profits in the Profit and Loss a/c. It is usually shown in the Balance Sheet as a deduction from the assets. Reserve on the other hand is an appropriation from the final profits, the assets by which they are represented form part of the capital employed of the business. Reserves are shown in the Balance Sheet as a part of the proprietor's interest.

16. Can loss in respect of speculation business carried on by the assessee be set off against profits and gains of any other business or profession?

No. loss in respect of speculation business can be set off only against profits from any speculation business

Check your progress 3

1. A _____ is usually made against anticipated losses and contingencies and is charged against the profits in the Profit and Loss a/c.
- contingency
 - provision
 - Reserve

1.5 Income Chargeable under the Head Business / Profession

The following incomes are chargeable to income tax under the head 'Profits and Gains of Business or Profession':

- The profits and gains of any business or profession which was carried on by the assessee at any time during the previous year
- Any compensation or other payment due to or received by any person specified by section 28(ii)
- Income derived by a trade, profession or similar association from specific performance for its members.
- Profit on sale of a licence granted under the Imports Control Order, 1955
- Cash assistance received or receivable by any person against exports under any scheme of the Government of India

- The value of any benefit or perquisite whether convertible into money or not arising from business or the exercise of a profession
- Any interest, salary, bonus, commission or remuneration due to or received by a partner of a firm
- Interest on securities if the business of the assessee is to invest securities, otherwise interest on securities shall be chargeable to income tax under the head 'Income from Other Source'
- Income from speculative transactions
- Any sum received under a Keyman Insurance Policy including bonus

Computation of income from Business when Profit and Loss Account is given:

The profit and loss account prepared by the assessee may not be correct from the income tax point of view as

- Several such expenses are charged to it which are wholly or partly inadmissible under the Income Tax Act.
- Some admissible expenses are omitted from it.
- Some taxable incomes are not credited to it and
- Some such incomes are credited which are either not taxable at all.

Format for Computation of Taxable Income from Business or Professions

Particulars	Rs.	Rs.
Profit as per Profit and Loss A/c.		xxxxx
Add:		
i) Expenses or losses not allowed but claimed/Charged to Profit & Loss A/c i.e. Household expenses, Income Tax, LIP, Bad Debts, Reserves, Interest on Capital, Personal Expenses etc.	xxxxx	
ii) Income taxable as business income but not credited to P & L A/c. i.e. Interest received on business		

Heads of
Income

investments, Sale of Assets used for Scientific Research	xxxxx	
iii) Expenses in excess of the allowed amount charged to P & L A/c. i.e. Excess Salary paid to relatives.	xxxxx	

iv) Under valuation of closing stock or over-valuation of opening stock	xxxxx	xxxxx
Less:		
i) Expenses or losses allowed but not debited to P & L A/c. e.g. Depreciation	xxxxx	
ii) Income not taxable as business but credited to the P & L A/c. e.g. Dividend, Profit on Sale of Investments, Rent from House Property.	xxxxx	
iii) Income exempt from tax but credited to P & L A/C. e.g. Grants and Subsidies.	xxxxx	

iv) Over-valuation of closing stock and under valuation of opening stock	xxxxx	Xxxxx

Taxable Income from Business		xxxxx

Note:1. If, instead of profit, there is loss as per the Profit and Loss Account, the above rules shall be reversed, i.e. items to be added shall be deducted and those to be deducted shall be added.

Computation of business income when the Cash Book or Receipt and Payment A/c. is available

When we have to assess persons engaged in some profession as doctors, Lawyers, Chartered Accountants etc. and instead of P & L A/c and a summary of their cash transactions is given in the form of each book or receipt and payment A/c. is made available to compute taxable gains of profession.

1. Consider the debit side and sort out the amounts pertaining to the profession and of revenue nature. The aggregate of these amounts is the gross income from the profession. Omit capital receipts e.g. sale of old furniture, equipments etc.
2. Thereafter consider the credit side and sort out the expenses relating to the profession and of revenue nature. Ignore capital disbursements e.g. Computer, Equipments purchased etc.
3. Consider the notes and additional information given to find out the amount of private and domestic expenses found mixed on the credit side of the summary. These amounts should be separated.
4. Take the total of 1 to 3 above and deduct it from (1) above to arrive at professional earnings.
5. Now observe again the debit side of the summary and find out income from other heads/sources etc. and expenses belong to these various incomes should be deducted from respective income.

Resulting figure will be taxable gain from profession.

Check your progress 4

1. Any sum received under a Keyman Insurance Policy will be taxed under _____.
 - a. Other sources
 - b. Business or profession
 - c. salary

1.6 Expenses allowed as Deduction from Profit and Gain of Business or Profession

1. **Expenses relating to Business Premises**
 - a. Rent, rates, taxes, repairs and insurance for premises and used for the purpose of business or profession.
 - b. Any sum paid on account of land revenue, local taxes or municipal taxes.
 - c. Insurance premium in respect of goods held in stock.
2. **Repairs and Insurance of Machinery, Plant and Furniture** - Current repairs and insurance of machinery, plant and furniture used for the purposes of the business of profession.
3. **Depreciation** - Depreciation is allowed subject to the following conditions:
 - a. The assessee is the owner of the asset.
 - b. The asset is used for the business purposes.
 - c. The asset is used in the relevant previous year. Depreciation is to be allowed as per income tax rules.

Depreciation on New Plant and Machinery - equal to 20% of the actual cost of such machinery or plant shall be allowed as deduction. No deduction shall be allowed in respect of Machinery or Plant a) before its installation by the assessee and was used by any other person or b) installed in any office premises or any residential accommodation guest house or c) the cost of which is allowed as a deduction by way of depreciation.
4. **Expenditure on Scientific Research (Sec.35)**
 - a. Revenue expenditure incurred by an assessee for scientific research relates to his business.
 - b. Where an assessee does not himself carry on scientific research but makes contributions to other institutions for this weighted deduction is allowed on one and on-fourth times of payment to a) and approved scientific research association b) to an approved university, college for the use of scientific research related or unrelated to the assessee.
5. **Expenditure incurred on the acquisition of Patent Rights or Copy Rights (Sec.35A)** - Any capital expenditure incurred (after 28-2-1966 but

before 1-4-1998) on the acquisition of a patent right or copyright used for the business shall be allowed as a deduction in 14 equal annual installments. Deduction shall be allowed in equal annual installments in as many years as are.

6. **Expenditure on Know-how (Sec.35 AB)** - Any lump-sum consideration paid by the assessee on or before 1-4-1998 for acquiring any know-how for use for the purpose of his business will be allowed as deduction by spreading it equally over six years.

The expenditure incurred on hi-house research and development by a company engaged in the business of bio-technology, pharmaceuticals, electronic equipment and computer etc. weighted deduction at 150% of the expenditure is allowed up to 31st March, 2007.

7. **Capital expenditure to obtain license to operate telecommunication services.**

8. **Payment to rural development fund (Sec. 35CCA)** - 100% deduction is allowed to an assessee who pays any sum to:

- a. The National Fund for the Rural Development (set-up and notified by the Central Government in this behalf).
- b. The National Poverty Eradication Fund (set-up and notified by the Central Government in this behalf).

9. **Other Deductions/Expenses**

- a. **Insurance Premium:** Any premium paid in respect of insurance against of damage or destruction of stocks or stores used for the purpose of business or profession.
- b. **Insurance Premium for the Health of Employee:** Amount paid for insurance on the health of employees in accordance with scheme framed by the G.I.C. of India or any other insurer and approved by I.R.D.A. of India approved by the Central Govt. is allowed as deduction.
- c. **Bonus or Commission paid to any Employee:** Any bonus or commission paid to an employee for services rendered shall be deductible only if such sum could not in any way be paid or divided. Similarly bonus declared but not paid up to the date of filing Income Tax Return is not allowed for deduction.

Heads of
Income

- d. **Interest on Borrowed Capital:** The amount of the interest paid or payable in respect of capital borrowed for acquiring a capital assets or a revenue asset for the purpose of the business or profession is allowed as deduction (Sec.43B).
- e. **Interest not “actually paid”:** If any sum payable by the assessee as interest on any loan or advance is converted into loan or borrowing or advance, the interest so converted and not actually paid shall not be deemed as “actual payment” and not allowed as deduction U/S 43 B. (w.e.f. 1/4/2006)
- f. Contribution to employees provident fund :
- g. Contribution to Approved Gratuity Fund and Superannuation Fund.
- h. Sales tax, Excise duty paid upto the date of filing the Income Tax Return and express incurred in connection with sale tax proceeding including appeals.
- i. Professional tax, central excise and custom duties.
- j. Bad debts incurred in previous year.

Expenses not allowed (u/s 37): In the case of any assessee, the following expenses are not allowed for computing the profit from business.

1. All taxes i.e. Income tax, Wealth tax, Estate & Death Duty except sales tax, Excise duty, Professional Tax and local Taxes.
2. All charities and donations including donations to political parties and others.
3. Interest on outstanding tax liability.
4. All types of provisions and reserves e.g. Provision made for bad and doubtful debts. Reserve Funds, provision for all types of taxes payable except creation of reserve by financial corporations.
5. All types of Personal expenses of the proprietor or partners e.g. salary paid to proprietor, personal life insurance premium.
6. Penalties paid on account of criminal proceedings.
7. Fines paid for breach of the Factories Act.
8. Penalty paid to customs or sales tax authorities in lieu of confiscation of goods or breach of law.

9. Any expenditure incurred on advertisement in any souvenir, brochure, tract, pamphlet etc. published by a political party.
10. All capital expenses except on scientific research.
All capital losses.

Heads of Income
Business or
Profession and
House Property

Check your progress 5

1. The first and foremost condition of charging depreciation is that the assessee _____ the owner of the asset.
 - a. must not be
 - b. must be

1.7 Expenses Expressly Disallowed (U/S 40)

1. Any interest royalty fees for technical services payable outside India if tax thereon has not been either paid or deducted at source.
2. Any expenditure not incurred wholly and exclusively for the purpose of the business or profession or expenses relating to other heads of income e.g. municipal taxes paid on house property.
3. Excessive or unreasonable payments (in the form of salary or wages or for supply of goods or services) to relatives.
4. Payment of expenditure exceeding Rs. 20,000 made other than crossed cheque or bank drafts. However there are some exceptions e.g. Payments made to central and State Govt.
5. All types of provisions e.g. Provisions made for bad debts, reserve fund or provisions for all types of taxes payable.
6. Contribution to non statutory funds.

Important: While computing the income from business or profession it is difficult to remember which expenses are allowed and which expenses are not allowed under the Act. Therefore, while solving the example apply the following general rules.

- All types of revenue expenses related to business are allowed for deductions.

Heads of
Income

- The expenses should be in respect of a business or profession carried on by the assessee and the profits and gains of which are to be computed and assessed.
- The expenses should not be in the nature of personal expenses of the assessee.
- The expenses should have been paid out or expended wholly and exclusively for the purpose of such business or profession.
- The expenses should not be in the nature of capital expenditure.
- The expenses should relate to the previous year concerned.

Problem with Solution

1. The following is the Profit and Loss account of Mr. Universe, Pune for the financial year ending on 31/3/10.

Profit and Loss Account

	Rs.		Rs.
To Salary	1,60,000	By Gross Profit	4,20,000
To Rent & Taxes	60,000	By Commission	42,000
To Commission	16,000	By Sundry receipt	4,200
To Advertisement	15,000	By Interest on Fixed Deposits	35,000
To R.D.D.	8,000	By Gift from Friend	2,900
To Depreciation	22,000		
To Conveyance	8,400		
To Stationary	15,200		
To Bonus	16,000		
To Contribution of R.P.F.	12,500		

To Interest on Capital	13,000		
To Net Profit	1,58,000		
	5,04,000		5,04,000

Check your progress 6

1. Payments _____ made to central and State Govt. above Rs. 20000 with out crossed cheque.
 - a. Can be
 - b. cannot

1.8 Additional Information

The following is the Profit and Loss A/c of X, for the year ended 31-3-2010. Compute his income from business for A.Y. 2010-11.

To opening Stock	15,000	By Sales	2,10,000
To purchases	40,000	By Closing Stock	20,000
To Wages	20,000	By Gift from father	27,000
To Rent	46,000	By Income tax refund	3,000
To Repairs of Motor Car	3,000		
To Wealth Tax paid	2,000		
To Medical Expenses	3,000		
To General Expenses	10,000		
To Motor Car	30,000		
To Provision for Dep. On	4,000		

Heads of
Income

motor car			
To Advance tax paid	1,000		
To profit for the year	86,000		
	2,60,000		2,60,000

Following further information is given:

1. X carries on his business for rented premises half of which is used as his residence.
2. The use of the car was 3/4th for the business and 1/4th for personal purposes.
3. Medical expenses were incurred during sickness of X for his treatment.
4. Wages included Rs. 2,500 on account of X's driver.
5. As per rule the rate of depreciation on Motor car is 20%.

Solution:

Income from business	Rs.	Rs.
Profit as per Profit and loss A/c		86,000
Add: Inadmissible expenses		
a. Wealth tax	2,000	
b. Private expenses (Medical expenses)	3,000	
c. Rent (50% premises are used for own residence)	23,000	
d. Motor car (capital expenditure)	30,000	
e. Advance tax	1,000	
f. Salary of driver (1/4th private	625	

Heads of Income
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purpose)		
g. Repairs of motor car (1/4th)	750	
Provision for depreciation	4,000 + 64,375	
		1,50,375
Less: Income credited to profit and loss A/c		
But not treated as business income.		
a. Gift from father	27,000	
b. Income-Tax refund	3,000 - 30,000	
		1,20,375
Less : Expenses allowed Depreciation on car (3/4th of Rs. 6,000)		-4,500
Income from business		1,15,875

Mr.Sagar is a registered medical practitioner. He keeps his books on cash basis and his summarized cash account for the year ended 31st March, 2010 is as under:

	Rs.		Rs.
Balance b/d	1,22,000	Municipal tax on house property	360
Loan from bank for private purposes	3,000	Cost of medicines	10,000
Sales of Medicines	5,250	Surgical equipments	8,000
Consultation fees	5,000	Motor car	1,20,000

Heads of
Income

Visiting fees	4,000	Car expenses	6,000
Interest on Govt. Securities	4,500	Salaries	4,600
Rent from house property	3,600	Rent on Dispensary	1,600
		General expenses	300
		Personal expenses	11,800
		Life insurance Premium	3,000
		Interest on Bank Loan	300
		Insurance on house property	200
		Deposit in Tatkal Telephone	30,000
		Balance c/d	41,190
	Rs. 2,37,350		Rs. 2,37,350

Compute his income from profession and house property for the A.Y. 2010-11 taking into account the following further information:

- One third of motor car expenses are in respect of his personal use.
- Depreciation allowed on car is 20% and surgical equipment is @ 25%.

Solution: Computation of Income from Profession and House Property,

Heads of Income
Business or
Profession and
House Property

A) Gross professional earning

	Rs.	Rs.
Sales of medicines	25,250	
Consultation fees	55,000	
Visiting fees	24,000	1,04,250
Less expenses allowed:		
Cost of Medicines	10,000	
2/3rd Car expenses (2/3 of Rs. 6000)	4,000	
Salaries	4,600	
Rent of Dispensary	1,600	
General expenses	300	
Depreciation		
Surgical Equipment @ 25% (on Rs. 8000)	2,000	
Motor car @ 20% on Rs. 1,20,000 = Rs. 24,000 × 2/3	16,000	-38,500
Income from profession		65,750
B) Income from House Property		
Gross Annual value		
Less Municipal Taxes	3,600	
	-360	
Net Annual value		
Less : Standard deduction @ 30% on NAV	3240	
Income from House Property	-972	
	2268	

Gross Total Income (A+B) = 65,750 + 2,268 = 68,018.

Income from House Property

Which income will be considered as ‘Income from House Property’?

The annual value of property, consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him, the profits of which are chargeable to income tax, shall be chargeable to income tax under the head “Income from House Property”.

Is income from any property covered under this section?

No. Only the income from buildings or part of a building, held by the assessee as the owner and the income from land appurtenant to the buildings is covered under this section. Income from other property such as open land is out of the purview of this section. Income from such land will be taxed under the head, ‘income from other sources.’

When the property is used by the owner for his business or profession, the income of which business or profession is chargeable to income tax, the income of that property is not charged in the hands of the owner. Similarly, when a firm carries on business or profession in a building owned by a partner, no income from such property is added to the income of the partner, unless the firm pays the partner any rent for the same. If the assessee is not the owner of the building but is a lessee and he sublets the property, he would be taxed under the head ‘Income from other sources’.

What is included in the term ‘buildings’ for the purpose of this section?

The term ‘buildings’ includes any building (whether occupied or intended for self-occupation), office building, godown, storehouse, warehouse, factory, halls, shops, stalls, platforms, cinema halls, auditorium etc. Income arising out of the building or a part of the building is covered under this section.

What is meant by the term “land appurtenant”?

Land appurtenant includes land adjoining to or forming a part of the building. It would depend on the nature of the land, whether it is appurtenant to the residential building, factory building, hotel building, club house, theatre etc. and will include courtyards, compound, garages, car parking spaces, cattle shed, stable, drying grounds, playgrounds and gymkhana.

Is the income arising from vacant land covered under this section?

Any income, arising out of vacant land, is not covered under this section even though it may be received as rent, ground rent or lease rent. Such income would be assessable as income from other sources. Even rent, arising out of open spaces, or quarry rent, is taxed as income from other sources.

If a company is formed with the sole object of acquiring and letting out immovable properties, what head would the rental income be taxable under?

Even if a company is formed for the sole object of acquiring and letting out immovable properties, the rental income would be taxable as “Income from House property” and not as “business income.”

If abuilding is used as a market and the owner/landlord provides certain other services as required by the municipal license, what head would the income fall under?

The income from letting out shops would be considered income from house property.

When is the income from house property wholly exempt from tax?

In the following cases, income from house property is completely exempt from any tax liability:

- Income from any farmhouse forming part of agricultural income;
- Annual value of any one palace in the occupation of an ex-ruler;
- Property Income of a local authority;
- Property Income of an authority, constituted for the purpose of dealing with and satisfying the need for housing accommodation or for the purposes of planning development or improvement of cities, towns and villages or for both. (The Finance Act, 2002, w.e.f. 1.4.2003 shall delete this provision.);
- Property income of any registered trade union;
- Property income of a member of a Scheduled Tribe;
- Property income of a statutory corporation or an institution or association financed by the Government for promoting the interests of the members either of the Scheduled Castes or Scheduled tribes or both;
- Property income of a corporation, established by the Central Govt. or any State Govt. for promoting the interests of members of a minority group;

Heads of
Income

- Property income of a cooperative society, formed for promoting the interests of the members either of the Scheduled Castes or Scheduled tribes or both;
- Property Income, derived from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities by an authority constituted under any law for the marketing of commodities;
- Property income of an institution for the development of Khadi and village Industries;'
- Self-occupied house property of an assessee, which has not been rented throughout the previous year;
- Income from house property held for any charitable purposes;
- Property Income of any political party.

How is the annual value of the property determined?

Under Section 23 (1) of the Income tax Act, annual value of property shall be deemed to be the following:

- The sum for which the property might reasonably be expected to be let out from year to year
- Where the property or any part of the property is let and the actual rent received or receivable by the owner in respect thereof is in excess of the sum referred to in clause (a), the amount so received or receivable
- Where the property or part of the property is let and was vacant during the whole or any part of the previous year and, owing to such vacancy, the actual rent received or receivable by the owner in respect thereof is less than the sum referred to clause (a) the amount so received or receivable.

The taxes levied by any local authority in respect of the property shall be deducted while determining the annual value of the property of that previous year in which such taxes are actually paid by him. Further, the amount of actual rent received or receivable by the owner shall not include the amount of rent, which the owner cannot realize.

Sub-section 2: The annual value of a house or part of a house shall be taken as nil if the property consists of such house or part of the house and is occupied by the owner himself for the purpose of his own residence or, if such house or part thereof cannot be occupied by him because his employment, business or profession is carried on at any other place and, he has to reside at that other place in a building that does not belong to him.

Nevertheless, the above provision would not apply if the house or part thereof is actually let during the whole or any part of the previous year; or if any benefit there from is derived by the owner.

If the property consists of more than one house, the provisions of the sub-section (2) shall apply in respect of only one of such houses, which the assessee may at his option specify. The annual value of the house(s), other than the house in which the assessee has exercised an option, shall be determined under sub-section (1) as if the house (s) had been let out

What are the deductions permitted to be made from Income from house property”?

S 24 lays down that ‘income chargeable under the head ‘Income from house property’ shall be computed after making the following deductions:

1. A sum equal to 30% of the annual value;
2. If the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital. Where such property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, on or after 1st April 2009, the amount of deduction under this clause shall not exceed Rs 1, 50,000 subject to condition that construction should be completed within three years from the end of year in which such loan was taken. However if loan is borrowed before 1-4-09 than interest allowed is Rs 30,000.

The amount of deduction shall not exceed Rs 30,000 where the property consists of a house or part of a house, which the owner occupies for his own residence or which cannot be occupied by him because his employment, business or profession is carried on at any other place and he has to reside at that other place in a building which is not his own.

Can rental income be treated as business income?

The main criteria for deciding whether the rent is assessable as income from property or as business income depends upon the assets are exploited commercially or whether the same are let out for enjoying the rent.

Problem

Mr. Nikhil owes two houses which he occupied for his own residence. He submits the following particulars in respect of these houses for the financial year 2006-07

Heads of
Income

	House I	House II
Date of completion of houses	15. 06. 1991	20. 12. 1991
	Rs.	Rs.
Municipal Value	12,000	24,000
Fair Rent	15,000	27,000
Standard Rent under Rent Control Act	9,000	20,400
Municipal Value	1,800	2,400
Amount spent on repairs	1,200	3,000
Interest on capital borrowed	3,000	30,000

You are requested to determine the taxable income from house property of Mr. Nikhil for the assessment year 2010-11

Solution

Since Mr. Nikhil occupies two houses for residential purpose. He can select any one house as self occupied property which is beneficial to him. Whereas the one will be treated as self occupied property.

Completion of income from house property for assessment year 2010-11.

	House I (Let out) Rs.	House II (S.O.H.P.) Rs.
Expected Rent – The following two as Standard Rent is applicable		
1) a) M.V. or F.R. whichever is higher or	15,000	N.A.
b) Standard Rent	9,000	N.A.

Heads of Income
Business or
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2) Expected Rent	9,000	N.A.
Gross Annual Value		
As the property is not actually let out Expected Rent will be Gross Annual Value	9,000	N.A.
Less : Municipal Tax	1,800	N.A.
Net Annual Value (A)	7,200	00
Less : Deductions (U/S 24)		
i) Standard Deduction 30% of N.A.V.	2,160	00
ii) Interest on borrowed capital	3,000	30,000
(B)	5,160	30,000
Income/Loss from H.P. (A-B)	2,040 - 30,000	
Net Loss from H.P. (2,40 - 30,000)	= - 27,960	

Problems

- Miss Aishwarya has occupied two houses for her residential purpose. The details of the houses are as follows.

Particulars	House I	House II
Municipal valuation	1,60,000	50,000
Fair rent	1,80,000	80,000
Standard rent under Rent Control Act	1,65,000	90,000
Municipal taxes (10% of municipal valuation)	10%	10%
Fire insurance	2,800	1,200

Heads of
Income

Miss Aishwarya has spent Rs. 20,000 as repairing charges on house II. You are required to calculate the income from house property of Miss Aishwarya for the assessment year 2010-11

2. Ashutosh owns three houses for his residential purposes. The following are the details of these houses.

Particulars	House I Rs.	House II Rs.	House III Rs.
Municipal valuation	82,000	50,000	70,000
Fair rent	75,000	60,000	65,000
Standard rent under Rent			
Control Act	70,000	70,000	65,000
Municipal taxes	8,200	6,000	7,000
Repairs	8,000	6,000	----

Ground rent is paid @ 10% of net annual value in respect of each house. Interest paid on capital borrowed for renewal of house property No. 1 & 3 amounting to Rs. 28,000 and Rs. 32,000 respectively, the loan was taken on 1st June 2000.

You are required to determine taxable income from house property of Mr. Ashutosh for the AY 2007-08

Check your progress 7

1. A sum equal to _____ of the annual value is allowed as standard deduction on house property.
- a. 40%
 - b. 30%

1.9 Let Us Sum Up

This unit discusses about the income which is generated from the income from business and profession. This head is one of the biggest head of income, involving so much of sections and its lengthy calculations. Best efforts have been made by the writer to explain the topics in most simple language.

In this unit we have studied about the term “profession” which implies professed attainments in special knowledge as distinguished from mere skill; “special knowledge” which is “to be acquired only after patient study and application”. The words ‘profits and gains’ are defined as the surplus by which the receipts from the business or profession exceed the expenditure necessary for the purpose of earning those receipts. These words should be understood to include losses also, so that in one sense ‘profit and gains’ represent plus income while ‘losses’ represent minus income. We even studied few of the expenses which are expressly disallowed under section 40 of the respective act.

This unit is certainly going to be of great help to the students in estimating the income from business and profession.

1.10 Answer for Check Your Progress

Check your progress 1

Answers: (1-b)

Check your progress 2

Answers: (1-a)

Check your progress 3

Answers: (1-b)

Check your progress 4

Answers: (1-b)

Check your progress 5

Answers: (1-b)

Heads of
Income

Check your progress 6

Answers: (1-a)

Check your progress 7

Answers: (1-b)

1.11 Glossary

1. **Vocation** – a person’s employment or main occupation, especially regarded as worthy and requiring dedication.

1.12 Assignment

What is the permissible deduction under the head “Profit and Gains of Business or Profession”?

1.13 Activities

What incomes are chargeable under the head “Profit and Gains of Business or Profession”?

1.14 Case Study

Mr. Ram is a chartered accountant and has the prepared the following income and expenditure account for the year ending 31-3-2010.

Income and Expenditure Account

Particulars	Rs.	Particulars	Rs.
Office expenses	10,000	Audit fees	70,500
Employees salary	5,000	Gift from father in law	5,050
Magazines	600	Dividend	8,000
Personal expenses	17,000	Profit on sale of Investment	6,450

Heads of Income
Business or
Profession and
House Property

Donation to N.D.F.	500	Tax consultancy fees	50,000
Interest	700		
Income tax	13,300		
Car expenses	2,000		
Net Surplus	91,000		
	1,40,000		1,40,000

You are required to compute his professional income for the assessment year 2007-08 considering the following points-

1. The car is used equally for official personal purposes.
2. Rs. 1,000 domestic servant's salary is included in employees salary.

1.15 Further Readings

1. Direct Taxes, Gupta and Ahuja.
2. The Economics of Taxation, Bernard Salanié, MIT Press, 1997.
3. The Economics of Taxation, Henry Aaron and Michael J. Boskan, The Brookings Institution, 1980.
4. Taxation: Its Principles and Methods, Luigi Cossa.
5. Taxation and Finance, S.M. Shukla.

UNIT 2: HEADS OF INCOME UNDER CAPITAL GAINS

Unit Structure

- 2.0 Learning Objectives**
- 2.1 Introduction**
- 2.2 Basis of Charge (Sec 45)**
- 2.3 Chargeability of Tax**
- 2.4 Some Important Definitions**
- 2.5 What is Capital Gain?**
- 2.6 Types of Capital Gains**
- 2.7 How is Short-term Capital Gain Taxed?**
- 2.8 How is Long-Term Capital Gain Taxed?**
- 2.9 Cost Inflation Index for the Various Financial Years**
- 2.10 How is Long-Term Capital Gain Taxed on Shares and Mutual Funds?**
- 2.11 Has the Capital Gain Calculation not Changed in the Case of Shares?**
- 2.12 Capital Loss**
- 2.13 Long Term and Short Term**
- 2.14 Seven Pillars of Capital Gain Treatment**
- 2.15 Computation of Capital Gain**
- 2.16 Let Us Sum Up**
- 2.17 Answer for Check Your Progress**
- 2.18 Glossary**
- 2.19 Assignment**
- 2.20 Activities**
- 2.21 Case Study**
- 2.22 Further Readings**

2.0 Learning Objectives

After learning this unit, you will be able to understand:

- Discuss chargeability of tax.
- Enlist the types of capital gains.
- Explain taxation of short-term and long-term capital gain.
- Define cost inflation index for the various financial years.
- Elaborate on taxation of long-term capital gain on shares and mutual funds.
- Describe the seven pillars of capital gain treatment.
- Practise on the computation of capital gain.

2.1 Introduction

Capital Gain means any profit or gain arising from the transfer of a capital asset. It is treated as income of the previous year in which the transfer takes place.

In general, capital receipts are not taxable. But gains or profits from transfer of certain assets is treated as income chargeable to income tax u/s 45.

Capital gains are subject to taxation as well. Generally capital gains receipts are not of regular nature. When ever a person disposes off his capital asset he may gain or may loose in that transaction. When he gains it is termed as capital gain and when he loses it is termed as capital loss. The capital gains are subject to taxation but not at normal rates but at special rates. The more elaborate and detailed discussion could be found here in the following discussion.

2.2 Basis of Charge (Sec 45)

Any profit or gain arising from the transfer of a capital asset is chargeable to tax under the head “Capital gains” in the previous year in which the transfer took place. Capital gains tax liability arises only when the following conditions are satisfied:

1. There should be a capital asset.
2. The capital asset is transferred by the assessee.
3. Such transfer takes place during the previous year.

4. Any profit or gain arises as a result of transfer

Check your progress 1

1. Any profit or gain arising from the transfer of a capital asset is chargeable to tax under the head _____.
 - a. Business profession
 - b. Capital gains
 - c. Other sources

2.3 Chargeability of Tax

The following gains are chargeable to tax under the head Capital gain.

1. Capital gains on the transfer of a capital asset (Sect. 45(1))

Any profits or gains arising from the transfer of a capital asset affected in the previous year shall be chargeable to income-tax under the head "Capital Gain".
2. Capital gains on receipt of compensation from insurance co. for damage or destruction etc. of capital asset (sect.45 (1) A)
3. Capital gains on the conversion of a capital asset into stock-in-trade (sect.45 (2)).
4. Profits and gains arising from the transfer of a capital asset by a partner to a firm shall be chargeable as the partner's income (Sect.43 (3)).
5. Profits and gains arising from the transfer of a capital asset by a firm to a partner on dissolution or otherwise shall be chargeable as the firm's income.
6. Capital gains on the compulsory acquisition of assets by the Govt.
7. Capital gain on transfer of business.

Check your progress 2

1. Capital gains on the transfer of a capital asset is chargeable under tax.
 - a. u/s Sect. 45(1)
 - b. u/s sec 45 (1) A
 - c. u/s sec 43(3)

2.4 Some Important Definitions

1. **Capital Assets (Sec2 (14)):** “Capital Asset” means property of any kind held by an assessee, whether or not connected with his business or profession but does not include the following:
 - Stock in trade of raw materials and consumable stores held for the purposes of business or profession.
 - Personal effects of movable nature such as furniture, utensils and vehicles held for personal use by the assessee or any dependant member of his family. However, Jewelry is a capital asset.
 - Agricultural land in India which is not situated in any specified area.
 - Gold bond issued under the gold deposit scheme. 1999 notified by the central Govt.
 - Special Bearer Bonds, 1991 issued by the Govt. of India. These have become irrelevant now as they have been redeemed.
2. **Short-Term Capital Assets (Sect. 2(42A)):** ‘Short-Term Capital Asset’ means capital asset held by as assessee for not more than 36 months immediately proceeding the date of transfer.

In case of the following assets this period stands reduced to 12 months.

 - a) Shares;
 - b) Any other security listed in a security listed in a recognized stock exchange in India;
 - c) Units of the U.T.I established under the U.T.I. Act, 1963;
 - d) Units of a Mutual Fund specified u/s 10(23D).
3. **Long-Term Capital Asset (Sec2 (29B)):** “Long-term capital asset” means a capital asset, which is not a short-term capital asset.
4. **Short-Term Capital Gains (Sec2 (42B)):** “Short-term capital gains” means capital gain arising from the transfer of a short-term capital asset.

Heads of
Income

5. **Long-Term Capital Gains (Sec2 (29B)):** “Long term capital gain” means capital gain arising from the transfer of a long-term capital asset.
6. **Transfer of Capital Assets:** Transfer, in relation to a capital asset, includes sale, exchange or relinquishment of the capital asset or in extinguishment of any rights there in or the compulsory acquisition thereof under any law. In case where the asset is converted by the owner into stock in trade, such conversion is also a transfer of capital assets.

However, certain transactions are not regarded as transfer, e.g.

- Distribution of assets by HUF to its family members at the time of total or partial partition.
- Distribution of assets by a company to its shareholders on liquidation.
- Transfer under a will or an irrevocable trust or a gift or deemed gift.
- Transfer of capital asset by a company to its wholly owned Indian subsidiary company and vice versa but not as stock in trade.
- Any transfer, in scheme of amalgamation of a capital asset by the amalgamating company, in the amalgamated company (Indian Company).

Capital Gains Tax - What Is the Capital Gains Tax?

As per AY 2010-11

Dividends that are distributed attract a tax of 15 per cent. Short term capital gains attract a tax of 10 per cent under Section 111A. There is merit in equating the rates and hence increased the rate of tax on short term capital gains under Section 111A 15 per cent.

STT paid will be treated like any other deductible expenditure against business income. Further, the levy of STT, in the case of options, is to be only on the option premium where the option is not exercised and the liability to be on the seller. In a case where the option is exercised, the levy is to be on the settlement price and the liability will be on the buyer.

Commodities Transaction Tax (CTT) introduced on the same lines as STT on options and futures.

Heads of Income
under Capital
Gains

	Short-term Capital gains tax	Long-term capital gains tax
Sale transactions of securities which attracts STT:	15%	NIL
Sale transaction of securities not attracting STT:-		
Individuals (resident and non-residents)	Progressive slab rates	20% with indexation; 10% without indexation
Partnerships (resident and non-resident)	30%	(for units/ zero coupon bonds)
Individuals (resident and non-residents)	30%	
Other Foreign companies	40%	20% with indexation; 10% without indexation
Local authority	30%	(for units/ zero coupon bonds)
Co-operative society	Progressive slab rates	

A capital gain is income derived from the sale of an investment. A capital investment can be a home, a farm, a ranch, a family business, or a work of art, for instance. In most years slightly less than half of taxable capital gains are realized on the sale of corporate stock. The capital gain is the difference between the money received from selling the asset and the price paid for it.

“Capital gains” tax is really a misnomer. It would be more appropriate to call it the “capital formation” tax. It is a tax penalty imposed on productivity, investment and capital accumulation.

Check your progress 3

1. Stock in trade of raw materials and consumable stores held for the purposes of business or profession _____treated as capital asset.
 - a. is
 - b. Is not

2.5 What is Capital Gain?

When you sell any asset you own (house, land, shares, mutual fund units, gold, debentures, bonds) and you make a profit on the sale, it is known as capital gain. The tax you pay on this profit is called the capital gains tax.

If you make a loss (sell at a lower price than bought it), you incur a capital loss.

Check your progress 4

1. Excess of sale proceeds of capital asset over its cost is treated as
 - a. capital gain
 - b. capital loss

2.6 Types of Capital Gains

Depending on how long you held the asset, the capital gain is classified either as short-term or long-term.

- **Short-term capital gain:** If you sell the asset within 36 months from the date of purchase (12 months for shares or mutual funds)
- **Long-term capital gain:** If you sell the asset after 36 months from the date of purchase (12 months for shares or mutual funds)

Check your progress 5

1. If you sell the asset within 36 months from the date of purchase, it will be treated as.
 - a. short term capital gain
 - b. long term capital gain

2.7 How is Short-Term Capital Gain Taxed?

This is very simple. A short-term capital gain is added to your total income. Depending on which tax bracket you fall under, you will be taxed.

Check your progress 6

1. A _____ capital gain is added to your total income.
 - a. short-term
 - b. long term

2.8 How is Long-Term Capital Gain Taxed?

Tax on long-term capital gain (other than shares and mutual fund units), is more complicated. This is because inflation is taken into account. This is good because it reduces the amount of capital gain and the amount you end up paying as tax.

Let's say Mr Mani purchased a house of Rs 2, 50,000 (Rs 250,000) on June 20, 1996. He sells it on January 20, 2010, for Rs 4, 50, 000 (Rs 450,000). Since the house was sold over 36 months after being bought, the capital gain will be long term.

First, you calculate the Cost Inflation Index. These indices are fixed and declared by the Central Government every year (see table below). This is called indexation.

Check your progress 7

1. Inflation index is used in case of
 - a. long term capital gain
 - b. short term capital gain

2.9 Cost Inflation Index for the Various Financial Years

FY	CII	FY	CII	FY	CII
1981-82	100	2000-01	406	1995-96	281
1982-83	109	2001-02	426	1996-97	305
1983-84	116	2002-03	447	1997-98	331
1984-85	125	2003-04	463	1998-99	351
1985-86	133	2004-05	480	1999-00	389
1986-87	140	2005-06	497		
1987-88	150	2006-07	519		
1988-89	161	2007-08	551		
1989-90	172	2008-09	582		
1990-91	182	2009-10	632		
1991-92	199	2010-11	711		
1992-93	223	2011-12	785		
1993-94	244	2012-13	852		
1994-95	259	2013-14	939		

Check your progress 8

1. If an asset has been acquired prior to 1981-81 then what will be the index used for that asset
 - a. No indexing will be done
 - b. 100
 - c. Will be treated as short term capital gain

2.10 How is Long-Term Capital Gain Taxed on Shares and Mutual Funds?

You can pay the tax on long term capital gains on shares and mutual funds either at the rate of 20% or 10%. The choice is yours.

This is how it is done.

Let us say that Mr. Mani purchased 4,000 shares on July 27, 2003 and paid Rs 10 per share. He sold them on September 15, 2004 for Rs 12 per share.

Since the investment is held for more than 12 months, the capital gain will be long-term.

If he computes with indexation using the above method, his capital gain will amount to Rs 6,532.

He will have to pay a tax of 20% on Rs 6532, which is Rs 1,306.

If he computes without indexation, this is the way it is done.

Sale proceeds = Rs 48,000 (4,000 shares x Rs 12)

Cost of acquisition = Rs 40,000 (4,000 shares x Rs 10)

Long-term capital gain = Rs 8,000

Tax payable will be 10% on Rs 8,000, which is Rs 800

Check your progress 9

1. You can pay the tax on long term capital gains on shares and mutual funds either at the rate of _____.
 - a. 10%
 - b. 20%
 - c. 20 % or 10 %

2.11 Has the Capital Gain Calculation not Changed in the Case of Shares?

From October 1, 2004, if you sell your shares, equity mutual funds and balanced mutual funds which have an equity component of 50% or more, the computation of tax differs.

If you have a short-term capital gain, the tax will be chargeable at 10%.

A long-term capital gain is not taxed.

On the flip side, no longer can you carry forward your long-term capital loss.

Check your progress 10

1. From October 1, 2004, if you sell your shares, equity mutual funds and balanced mutual funds which have an equity component of 50% or more, the computation of tax _____.
 - a. Differs
 - b. Same

2.12 Capital Loss

The loss incurred when a capital asset (investment or real estate) decreases in value. This loss is not realized until the asset is sold for a price that is lower than the original purchase price.

A capital loss is essentially the difference between the purchase price and the price at which the asset is sold, where the sale price is lower than the purchase price.

For example, if an investor bought a house for Rs.250,000 and sold the house five years later for Rs.200,000 the investor would realize a capital loss of Rs.50,000.

- Long-term capital loss can be set off only against a long-term capital gain.
- Short-term capital loss can be set off against any type of capital gain, long-term or short-term.

You need not incur the loss and gain in one single year. A long-term capital loss can be carried forward for eight years to be set off against a long-term capital gain.

A short-term capital loss can be set off against any income under the head capital gains (whether short-term or long-term) and can also be carried forward for eight years.

In both cases, these eight years start after the financial year when the loss is incurred.

In finance, a capital gain is profit that results from the sale or exchange of a capital asset over its purchase price. If the price of the capital asset has declined instead of appreciated, this is called a capital loss. Capital gains occur in both real assets, such as property, as well as financial assets, such as stocks or bonds. For equities, according to each national or state legislation, a large array of fiscal obligations must be respected regarding capital gains and taxes are charged by the state over the transactions, dividends and capital gains on the stock market. However, these fiscal obligations may vary from jurisdiction to jurisdiction because, among other reasons, it could be assumed that taxation is already incorporated into the stock price through the different taxes companies pay to the state, or that tax free stock market operations are useful to boost economic growth.

Check your progress 11

1. _____ is essentially the difference between the purchase price and the price at which the asset is sold. where the sale price is lower than the purchase price.
 - a. A capital gain
 - b. A capital loss

2.13 Long Term and Short Term

Generally, appreciated capital assets sold by an individual after being held more than one year (long-term capital gain) will be taxed at a maximum rate of 15%. For taxpayers earning less than \$15,000 annually the tax rate on long-term capital gains is only 5% and will be 0% after 2008. For the sale of collectibles and small business stock, the rate of taxation for individuals is a maximum of 28%. Appreciated capital assets that are sold by individuals after being held for one year or less (short-term capital gain) will be taxed as ordinary income, which rises as high as 35% in the U.S. progressive tax system. Capital gains by entities taxed as corporations do not receive preferential treatment and are taxed at a maximum rate of 35 percent.

Check your progress 12

1. Capital gains by entities taxed as corporations do not receive preferential treatment and are taxed at a maximum rate of _____.
 - a. 35 percent
 - b. 10 percent
 - c. 50 percent

2.14 Seven Pillars of Capital Gain Treatment

Seven Pillars of Capital Gain Treatment for deciding if properties were held for investment purposes or primarily for sale to customers in the ordinary course of his trade or business and therefore warranted capital gains treatment under I.R.C. (Internal Revenue Code) 1201, 1202.

1. The nature and purpose of the acquisition of the property and the duration of the ownership
2. The extent and nature of the taxpayer's efforts to sell the property
3. The number, extent, continuity and substantiality of the sales
4. The extent of subdividing, developing and advertising to increase sales
5. The use of a business office for the sale of the property

6. The character and degree of supervision or control exercised by the taxpayer over any representative selling the property
7. The time and effort the taxpayer habitually devoted to the sales

Other countries

There is currently no capital gains tax after a holding period of more than one year for equities. However, 15% of tax is applied for short term equity-shares gain. This is applicable only for transactions that attract Securities Transaction Tax (STT).

As of 2006, shares / equities are considered long term capital, if the holding period is one year or more. Long term capital gains are taxed either at 10% of earnings or 30% of (earnings - deduction based on inflation index).

Short term capital gains are taxed just as any other income and they can be negated against short term capital loss from the same business.

Many other capital investment (home, buildings, real estate, bank deposits) are considered long term if the holding period is 3 or more years.

- India
- United Kingdom
- People's Republic of China
- South Africa
- Australia
- France
- Canada
- Indonesia
- Spain

Check your progress 13

1. _____ capital gains are taxed just as any other income and they can be negated against short term capital loss from the same business.
 - a. Long term
 - b. Short term

2.15 Computation of Capital Gain

A) Computation of Short Term Capital Gains (i.e. gains arising from the transfer of a short term capital assets)

Short term capital gain is computed as under.

Full consideration on transfer (selling price)		xxxx
Less: 1) Cost of acquisition of Asset	xxxx	
2) Cost of improvement to the asset	xxxx	
3) Expenditure on transfer of Assets	xxxx	xxxx
Short term capital gain	xxxx	
Less Exemption u/s 54		xxxx
Short term capital gain (chargeable to tax)		xxxx

B) Computation of Long Term Capital Gain

(i.e. gain arising from the transfer of L.T.C.A.)

Full consideration on sale or transfer	xxxx
Less: 1) Indexed cost of acquisition	xxxx
2) Indexed cost of improvement	xxxx
3) Expenditure on sale/transfer	xxxxxxxx
L.T.C.G.	xxxx
Less: Exemption under section 54	xxxxxxxx
L.T.C.G. chargeable to tax	xxxx

Full value of consideration: It means the total price; the transferor of asset receives for giving up his right on the capital asset transferred. The 'full value' means the whole price paid without any deduction.

Cost of acquisition: The cost of acquisition of an asset is the value for which it was acquired by the owner. The cost includes any expenditure of capital nature incurred for completing or acquiring the title to property.

Indexed cost of acquisition: In case of long term capital gain the amounts to be deducted from the full value of consideration includes 'indexed cost of acquisition and improvement'.

Indexed cost of acquisition means the amount which bears to the cost of acquisition, the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the cost inflation Index for the first year in which the asset was held by the assessee or for the year beginning on April 1, 1981, whichever is later. In short the indexed cost of acquisition is computed as under.

Cost of Improvement: The cost of improvement means any expenditure done for increasing the value of asset. All expenses of capital nature incurred in making any addition / alteration to the capital assets are included in the cost of improvement.

The students should note here that if an assessee chooses option to the substitute to the cost of acquisition of assets with its market value on 1.4.81, the cost of improvements done before this date shall not be allowed as deduction while computing the capital gain.

Indexed cost of Improvement: Indexed cost of improvement means the amount which bears to the cost of improvement, the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the improvement to the asset takes place.

Problems with Solution:

1. Mr. 'A' purchased a residential house for Rs. 3, 50,000 on 15th June 2007. Expenses incurred for purchases of Rs. 10,000. He sold the house on 1st August 2009 for Rs. 4, 13,000. Expenses incurred on sale Rs. 7,000. He made an expenditure of Rs. 15,000 on 7th June 2008 for the construction of an additional bathroom. Compute the capital gain.

Solution:

The house purchased on 15th June 2007, sold on 1st August 2009, i.e. within three years (36 months) so the gain from the house is short term capital gain.

	Rs.
Full consideration of house	4, 13,000
Less: i) Cost of acquisition	3, 60,000
(3, 50,000 + 10,000)	
ii) Cost of improvement	+ 15,000
iii) Expenses on sale	+ 7,000
Short Term Capital Gain	-3, 82,000
	31,000

Heads of
Income

2. From the following information compute capital gains for the assessment year 2010-11:

	House I	House II
Date of purchase	May, 1977	Dec, 1980
	Rs.	Rs.
Cost of acquisition	1, 90,000	2, 50,000
Cost of additional construction in 1980	10,000	25,000
Fair Market value on 1st April, 1981		1, 75,000
		3, 50,000
Cost of additional construction in 1995-96		51,800
		77,700
Sale proceeds of property in 2009-10	13, 50,000	29, 00,000
Cost inflation index are: 1981-82—100; 1995-96—259; 2009-10—632.		

Solution: Computation of Capital Gains

Rs.

House I : Selling price 13,50,000

Less: i) Indexed Cost of acquisition before 1.4.1981

Rs. 1, 90,000 + 10,000 or Fair Market value on 1.4.1981

Rs. 1, 75,000 whichever is more.

Hence, $2, 00,000 \times \frac{632}{100} = 1,264,000$

100

ii) Indexed cost of improvement in 1995-96

$51,800 \times \frac{632}{259} = 126400$ 1390400

259 L.T.C. Loss -40,400

House II: Selling price 29, 00,000

Less: i) Indexed Cost of Acquisition + additional construction

Before 1.4.1981 (Rs. 2, 50,000 + 25,000) or Fair Market value on

1.4.1981 Rs. 3, 50,000, whichever is more

Hence, $3, 50,000 \times \frac{632}{100} = 22, 12,000$

ii) Indexed Cost of improvement in 1995-96

$$\begin{aligned}
 &77,700 \times 632 &&= + 1, 89600 &&- 189600 \\
 &259 &&\text{L.T.C.G.} &&\text{Rs. 498400} \\
 &&&&&= \text{Rs. 498400} - 40,400 = 458000
 \end{aligned}$$

Total Long-term Capital Gains

Note: 1. Capital expenditure incurred prior to 1.4.1981 will not be added to arrive at the cost of acquisition as fair market value on 1.4.1981 includes in it.

Note: 2. Actual cost of acquisition is ignored as it is lower than fair market value as on 1.4.1981.

Deductions allowed for capital gains: Short term capital gains are taxable like any other income.

If income under other heads are taxable, the L.T.C.G. is taxable at a flat rate of 20% (plus surcharge) for the A.Y. 2010-11.

Following deductions are allowed from capital gain:

Any profits or gains arising from the transfer of the following assets are exempt from tax i.e. it will not be included in the income of the assessee for tax purposes.

1. Capital Gains arising on the transfer of property used for residential purpose. (sec. 54) - Any capital gain arising on the transfer of a house or land appurtenant there to exempt subject to the following conditions:

- The building is owned by an individual or HUF.
- Such property was being used as residential house and is chargeable under the head 'Income from house property'.
- The house property had been held by the tax payer for a period exceeding 36 months before transfer.
- The assessee has, within a period of one year before or two years after the date of transfer purchased a residential house; or He has within a period of three years after the date of transfer constructed a residential house.

Heads of
Income

- The amount of capital gain (if can not be utilized for the acquisition of the new house) is deposited by him on or before the due date of furnishing the return of income; in Capital Gains Account Scheme, 1988.

Quantum of Exemption: Amount of capital gain or the cost of new residential house purchased or constructed within the specified period whichever is lower.

2. Capital gain arising from the transfer of agricultural land (Sec 54B) -

Any capital gain arising on the transfer of agricultural land situated in an urban area is exempt from tax subject to the following conditions:

- The land is owned by an individual.
- The agricultural land was, in the two years immediately preceding the date of transfer being used either by the assessee or his parent (as owner or otherwise) for agricultural purposes.
- The assessee has purchased within a period of two years from the date of transfer or sale any other land for agriculture purposes.
- The amount of capital gain deposited by him on or before the due date for furnishing the return of income in 'Capital Gains Account Scheme, 1988'.
- The new land should not be transferred within three years.

Quantum of Exemption: The capital gain arising from the transfer of such agriculture land is exempt to the extent of the cost of the new agricultural land purchased within the specified period.

3 Capital Gain on compulsory acquisition of lands and buildings (Sec 54

D) - Any capital gain arising on the transfer, by way of compulsory acquisition under any law, of land or building exempt from tax subject to the following conditions.

- The land or building was used by the assessee at least for two years for the purpose of an industrial undertaking
- The assessee has within a period of three years after such transfer purchased any other land or building or constructed it for the purpose of shifting or re-establishing the another industrial undertaking or

- Deposited the amount of capital gain not utilized as above, in the “Capital Gains Account Scheme, 1988” before the due date of furnishing the return of income
- The new land or buildings should not be transferred within three years otherwise the exempted amount will be taxable.

Quantum of Exemption: The amount of capital gain or the cost of new land and building whichever is lower.

4. Capital Gain arising from transfer of long term listed securities or units invested in specified equity shares (Sec 54 ED) - (w.e.f. A.Y. 2002-03)

The assessee shall be entitled to exemption as per the following conditions:

- The new assets should be purchased within six months.
- The amount of capital gain is exempted to the extent of the cost of new assets.
- The new assets should not be transferred or sold within one year from the date of acquisition; otherwise the exempted amount of capital gain shall be chargeable to tax as L.T.C.G. of the previous year in which the new asset is transferred.
- It is proposed to withdraw the exemption under this section.

5. Exemption from tax on long-term capital gains on investment of the consideration in residential house (Sec 54 F) - If the following conditions are satisfied, the Long Term Capital Gains is exempted from tax.

- The assessee is either an individual or HUF.
- The assessee has transferred a long-term capital asset other than residential house.
- The assessee does not own more than one residential house on the date of transfer other than as mentioned in (iv) below.
- The tax payer purchases within a year before or within two years or constructs within a period of three years after the date of transfer a residential house.
- He should also not purchase within a period of one year after the date of transfer of the original asset or construct within a period of three years after the aforesaid date any residential house other than the house stated in (iv) above.

Withdrawal of exemption u/s 54 F:

If the assessee transferred the new house within three year of its purchase / construction. a) the capital gain on new house will be treated as Short Term Capital Gain and b) previously exempted amount will be taxable as Long Term Capital Gain in the year which the new asset is transferred.

Quantum of Exemption:

1. If the cost of new house is more than the net consideration of the assets transferred – The entire capital gain is exempted.
2. If the cost of the new house is less than the net consideration of the assets transferred. The exemption from L.T.C.G. will be granted proportionately on the basis of investment of net consideration

$$\frac{i.e. (Cost\ of\ new\ house \times Capital\ gains)}{Net\ consideration}$$

Check your progress 14

1. If the assessee transferred the new house within three year of its purchase / construction. The capital gain on new house will be treated as _____Capital Gain.
 - a. Short Term
 - b. Long term

2.16 Let Us Sum Up

In this unit we have discussed in detail about the capital gain. We have discussed that capital Gain means any profit or gain arising from the transfer of a capital asset. It is treated as income of the previous year in which the transfer takes place and any profit or gain arising from the transfer of a capital asset is chargeable to tax under the head “Capital gains” in the previous year in which the transfer took place. But there are certain conditions for chargeability of capital gain and they are that there should be a capital asset. The capital asset is transferred by the assessee. Such transfer takes place during the previous year and any profit or gains arises as a result of transfer.

Later in this unit we discussed the taxability of capital gains and even about capital loss and its treatment. This unit is certainly going to help the students in understanding the capital gain and make its calculation.

2.17 Answer for Check Your Progress

Check your progress 1

Answers: (1-b)

Check your progress 2

Answers: (1-a)

Check your progress 3

Answers: (1-b)

Check your progress 4

Answers: (1-a)

Check your progress 5

Answers: (1-b)

Check your progress 6

Answers: (1-a)

Check your progress 7

Answers: (1-b)

Check your progress 8

Answers: (1-b)

Check your progress 9

Answers: (1-b)

Heads of
Income

Check your progress 10

Answers: (1-a)

Check your progress 11

Answers: (1-b)

Check your progress 12

Answers: (1-a)

Check your progress 13

Answers: (1-b)

Check your progress 14

Answers: (1-a)

2.18 Glossary

1. **Short term** - Less than one(in case of securities) /three years.
2. **Long term** - More than one year in case of securities /three years.

2.19 Assignment

What is Capital Gain? What are the various types of Capital Gain?

2.20 Activities

Explain the term “Capital Assets” in detail.

2.21 Case Study

Collect all sections connected with Tax Exemptions. Prepare a table on the collected data.

2.22 Further Readings

1. Direct Taxes, Gupta and Ahuja.
2. The Economics of Taxation, Bernard Salanié, MIT Press, 1997.
3. The Economics of Taxation, Henry Aaron and Michael J. Boskan, the Brookings Institution, 1980.
4. Taxation: Its Principles and Methods, Luigi Cossa.
5. Taxation and Finance, S.M. Shukla.

UNIT 3: HEADS OF INCOME – OTHER SOURCES

Unit Structure

3.0 Learning Objectives

3.1 Introduction

3.2 Income from Other Sources (Sec 56)

3.2.1 Dividends

3.2.2 Any Winning from Lotteries, Crossword Puzzles or Races

3.3 Method of Accounting

3.4 Interest on Securities

3.5 Basis of Charge

3.6 Kinds of Securities

3.7 Profit and Loss on Sale of Securities

3.8 Tax upon Income from Other Sources

3.9 Problem with Solution

3.10 Let Us Sum Up

3.11 Answer for Check Your Progress

3.12 Glossary

3.13 Assignment

3.14 Activities

3.15 Case Study

3.16 Further Readings

3.0 Learning Objectives

After learning this unit, you will be able to understand:

- Define income from other sources (Sec 56).
- Specify the method of accounting.

- Describe interest on securities.
- Explain profit and loss on sale of securities.
- Calculate the tax upon Income from other sources.

3.1 Introduction

A source of income which does not specifically fall under any one of the other heads of income, viz. Salaries, House Property, Profits and Gains of Business and Profession, Capital Gains such income is taxed u/s 56 under the head Income from Other Sources.

The residuary head of income can be invoked only if all the following conditions are satisfied:

1. There is an income.
2. Such income is not exempt from tax u/s 10 to 13 A.
3. Such income does not fall under any of the other 4 heads of income.

3.2 Income from other sources (Sec 56)

The following incomes are always chargeable to tax under 'Income from other sources'.

3.2.1 Dividends

Any dividend declared, distributed and paid by a company to its shareholders is chargeable to tax under this head irrespective to the fact whether shares are held by the assessee as investment or stock in trade.

The following distributions or payments made by a company shall be covered by the term dividend.

- a. Any distribution entailing the release of companies assets.
- b. Any distribution of accumulated profits in the form of debentures, debenture-stock, deposited certificate and bonus to preference shareholders.

Heads of
Income

- c. Distribution of accumulated profits at the time of liquidation of a company.
- d. Distribution of accumulated profits on reduction of its capital.
- e. Any payment by way of loan or advance by a closely-held company to shareholder, holding substantial interest, provided the loan should not have been made in the ordinary course of business.

Tax treatment: The dividend declared or paid by the domestic company after 31.03.1997 but before 1 April 2002 was exempted from the tax in the hands of shareholders. Dividends declared, distributed or paid by company after 31 March 2002, (i.e. w.e.f. A.Y. 2003-04) was taxable in the hands of the shareholders. Dividend received from non-domestic company is fully chargeable to tax w.e.f. 1.4.2003, i.e. from A.Y. 2004-05, the dividends declared or paid by the domestic company is fully exempted from tax in the hands of the shareholders.

3.2.2 Any Winning from Lotteries, Crossword Puzzles, Races

Any winning from lotteries, crossword puzzles, races including horse races, card games and any other games of any sort or from gambling or betting of any form of nature whatsoever is taxable.

Tax treatment: Up to the assessment year 2002-03 winning from lotteries up to Rs. 5000 and in case of winning from races including horse races up to Rs. 2500 were exempted from tax. Now this exemption w.e.f. A.Y. 2003-04 is not available. It is fully taxable at the flat rate of 30% + surcharge (if applicable) + Education.

1. Any sum received by the assessee from his employees as staff welfare scheme.
2. Interest on securities. (Discussed later on in this unit).
3. Income from machinery, plant or furniture let on hire (if it is not taxable under the head 'Profits and Gains of businesses).
4. Income from letting of plant or furniture along with the building and letting of building is inseparable from the letting of plant, machinery or furniture (if it is not taxable under the head 'Profits and Gains of businesses).
5. Any sum received under a Keyman insurance policy including bonus if not taxable as salary or business income.

Besides, the following income is also chargeable under the head 'Income from other sources'.

Heads of Income –
Other Sources

- a. Income from subletting
- b. Interest on bank deposits and loans
- c. Income from royalty (if it is not an income from business)
- d. Directors fee
- e. Agricultural income from a place outside India
- f. Directors commission for standing as a guarantor to bankers
- g. Directors commission for underwriting shares of new company
- h. Examination fees received by a teacher from a person other than his employer
- i. Rent on plot of land
- j. Insurance commission
- k. Annuity payable under a will, contract, trust deed
- l. Salaries payable to a Member of Parliament
- m. Family pension received by family members of deceased employee
- n. In case of retirement, interest on employees contribution if provident fund is unrecognised
- o. Income from undisclosed source
- p. Gratuity paid to a director who is not employee of the company
- q. Annuity payable to the lender of trade mark

Check your progress 1

1. Salaries payable to a Member of Parliament is taxable under the head
 - a. Other sources
 - b. Salary

3.3 Method of Accounting

There are two methods of accounting generally employed by the assessee - mercantile and cash. His income under the head income from other sources for the previous year is computed in accordance with the method of accounting regularly employed by him. If he is employing mercantile system, all the income whether received or not and expenditure related to the previous year whether paid or not is considered. If he is employing cash system of accounting, all income received whether related to the previous year or not and all expenses paid whether due or not are taken into consideration for determination of income.

Check your progress 2

1. There are two methods of accounting generally employed by the assessee - mercantile and _____.
 - a. accrual
 - b. cash

3.4 Interest on Securities

The income from interest on securities shall be chargeable to tax under the head 'Income from other sources'. If securities are held as stock-in-trade then interest on it is taxable under the head business or profession.

The following amounts are chargeable to income tax as interest on securities:

1. Interest on any security of the Central or State Governments
2. Interest on debentures or other securities issued by local authority or by a company
3. Interest on debentures or other securities issued by a statutory corporation

Check your progress 3

1. The income from interest on securities shall be chargeable to tax under the head
 - a. Income from other sources'
 - b. Income from business and profession

3.5 Basis of Charge

Interest on securities is chargeable to tax on basis of accounting method (cash or mercantile) followed by the assessee. However, where no method of accounting is regularly employed by the assessee, the income from interest on securities shall be chargeable to tax as the income of the previous year in which it becomes though it may be received later.

Check your progress 4

1. Interest on securities is chargeable to tax on basis of _____ followed by the assessee.
 - a. cash method
 - b. accounting methodc. accrual method

3.6 Kinds of Securities

- **Tax free Government Securities:** Interest on such securities is neither included in total income nor it is taxed, i.e. It is fully exempted from tax.
- **Less-Tax Government Securities:** Such securities are issued either by the Central or State Government. These are taxable securities, but no tax is deducted at source on such securities. Hence, the interest on such securities will not grossed up.
- **Tax-free Commercial Securities:** These are issued by a local authority or statutory corporation or a company, in a form of debentures or bonds. Really speaking their interest is not tax free, because the tax due on this interest is payable by the company or local authority or corporation concerned. These

Heads of
Income

are called tax free, because the assessee has not to pay tax on it from his own pocket.

- **Less-Tax Free Commercial Securities / Taxable Securities:** In the case of these securities, income tax is deducted at source on the amount of interest and balance is paid to the security holder. The net amount of interest received is grossed up and then included in the total income of an assessee.

E.g. interest received on debentures and other securities after deduction of tax at source at 21.2% (including education cess at 2%) is Rs. 19390. Interest to be included in income will be grossed up by applying the following formula:

$$\frac{\text{Net interest received}}{78.80 (100-21.2)} \times \frac{100}{1} \times \frac{19390}{78.80} \times \frac{100}{1} = 24,606$$

Rs.24, 606/- as a income from interest on securities will be added in other income.

Tax on Rs.24, 606 at 20%	Rs.4, 921
+ Education Cess at 2% on Tax	Rs. 98
Total Tax	Rs.5,019

Check your progress 5

1. _____ Government Securities is fully exempted from tax.
 - a. Taxable
 - b. Tax free

3.7 Profit and Loss on sale of Securities

If the purchase and sale of securities is the business of the assessee, then the profit on sale of securities is taxable under the head 'Profits and Gains of business or profession'. On the other hand if the securities are held as an investment to earn interest thereon the profit on sale of securities is capital gain.

Deductions allowable under the head income from other sources

The income chargeable to tax under the head 'Income from other sources' shall be computed after making the following deductions:

- In respect of dividend and interest, any reasonable expenditure incurred by way of commission or remuneration for realisation of such income.
- In respect of family pension a sum equal to 33 1/3 % of the pension or Rs. 15,000 whichever less.
- In respect of income earned by way of letting out of machinery, plant & furniture with or without building – a) repairs b) insurance c) depreciation of that machinery, plant or furniture.
- Any other expenditure incurred by the assessee, not being capital expenditure, for the purpose of making or earning any income chargeable under this head of income.

Amount not deductible (Inadmissible Expenses) Sect. 58

1. Any personal expenses of the assessee
2. Wealth tax
3. Expenses of the nature described in section 40 A.

Interest paid or payable outside India, if tax has not been paid or deducted at source.

Check your progress 6

1. Interest paid or payable outside India, if tax has not been paid or deducted at source is considered _____.
 - a. admissible
 - b. inadmissible u/s 58

3.8 Tax upon Income from Other Sources

What income would fall under the head “income from other sources”?

Income of every kind, which is not chargeable to income tax under the heads 1) salary 2) income from house property, 3) profits and gains of business and profession and capital gains can be taxed under the head “income from other sources”. However such income should also not fall under income not forming part of total income under the IT Act.

Heads of
Income

The following income shall be chargeable to income tax under the head “Income from other sources”, namely: -

1. Dividend
2. Any annuity due or commuted value of any annuity paid under section 280D
3. Any winning from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever
4. Any sum, received by the assessee from his employees as contributions to any provident fund or Superannuation fund or any fund set up under the provisions of the Employees State Insurance Act, 1948 (34 of 1948), or any officer fund for the welfare of such employees, if such income is not chargeable to income-tax under the head “Profits and gains of business or profession”
5. Income from machinery, plant or furniture belonging to the assessee and let on hire, if the income is not chargeable to income -- tax under the head “Profits and gains of business or profession”
6. Where an assessee lets on hire machinery, plant or furniture belonging to him and also buildings and the letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, the income from such letting, if it is not chargeable to income tax under the head “Profits and gains of business or profession”
7. Any sum received under a Keyman insurance policy, including the sum allocated by way of bonus on such policy, if such income is not chargeable to income tax under the heads “Profits and gains of business and profession” or under the head “Salaries”. (Keyman insurance policy means a life insurance policy taken by a person on the life of another person who is/ was the employee of the 1st mentioned person or who is/was connected in any manner whatsoever with the business of the 1st mentioned person.)

So, basically “income from other sources” is the residuary head of income, which takes within its ambit any income, which does not specifically fall under any other head of income.

If certain Income is not chargeable to tax under the specific head, can it be taxed under the head “Income from other sources”?

If a receipt falls under one of the specific heads of income, then such receipt can be taxed only in accordance with the provisions relating to that head. Income

of every kind, which is not chargeable to income tax under the heads 1) salary 2) income from house property, 3) profits and gains of business and profession and capital gains can be taxed under the head “income from other sources”. However, this is subject to the condition that such income does not fall under income, not forming part of total income under the IT Act and provided that it is not exempted from taxation under any provision of the I-T Act.

Is the dividend income of all assesseees liable to tax?

There are certain assesseees who are exempted in respect of the taxability of dividend income and therefore, dividend income in the hands of these particular assesseees, to the extent as specified in the section, is not taxable even though the same falls under the head “Income from other sources”. The dividend income, earned by the following entities or institutions, is exempt from tax, namely:

1. Local Authorities.
2. An approved scientific research association.
3. A venture capital fund or venture capital company from investments made by way of equity shares in a venture capital undertaking.
4. Notified news agency.
5. Pension fund set up by LIC or any other insurer approved by the Controller of Insurance or Insurance Regulatory and Development Authority.
6. Fund established for the welfare of employees.
7. Trust or society approved by Khadiand Village Industries Commission.
8. An authority whether known as Khadiand Village Industries Board or any other name for the development of Khadiand Village Industries.
9. Any body or authority established, constituted or appointed under any enactment for the administration or public, religious, or charitable trusts or endowments or societies for religious or charitable purposes.
10. SAARC Fund for Regional Projects.
11. Secretariat of Asian Organisation of Supreme Audit Institutions.
12. Insurance Regulatory and Development Authority.
13. Any person, receiving income on behalf of specified national funds, approved public charitable institutions, educational institutes and hospital.

Heads of
Income

14. Mutual funds registered under SEBI Act or set up by a public sector bank or a public financial institution or authorised by the Reserve Bank of India. However, w.e.f. 1.4.20003, income from units of the UTI and mutual funds will also be taxed.
15. Investor Protector Fund.
16. Credit Guarantee Fund Trust.
17. Infrastructure capital fund.
18. Statutory provident funds, Recognised provident funds, Approved Superannuation funds, approved gratuity funds and approved coal mines provident funds.
19. Registered Trade Unions or association of Registered Trade Unions.
20. Employees State Insurance Fund.
21. Members of a Scheduled Tribe, residing in Manipur, Nagaland, Tripura, Arunachal Pradesh, Mizoram and Ladakh.
22. Statutory Corporation or abody/ institution financed by the Govt., formed for promoting the interest of Scheduled castes/tribes, minority community.
23. Co-operative societies formed for promoting the interest of Scheduled castes/tribes.
24. Marketing authority, engaged in letting godowns and warehouses.
25. Certain Commodity Boards/ Authorities.
26. Political parties.

Would the interest income be assessed as ‘business income’ or as ‘income from other sources’?

Interest Income is either assessed as ‘Business Income’ or as ‘Income from other sources’ depending upon the activities carried on by the assessee. If the investment yielding interest is part of the business of the assessee, the same would be assessable as ‘business income’ but where the earning of the interest income is incidental to and not the direct outcome of the business carried on by the assessee, the same is assessable as ‘Income from other sources’. Business implies some real, substantial and systematic or organised course of activity with a profit motive. Interest, generated from such an activity, is business Income; else it would be interest from other sources.

What are the deductions allowed under the head ‘Income from other sources’?

The income, chargeable under the head ‘income from other sources,’ shall be computed after making the following deductions:

- In the case of interest on securities, any reasonable sum, paid by way of commission or remuneration to a banker or to any other person for the purpose of realising such dividend or interest on behalf of the assessee;
- In the case of income, received by the assessee from his employees as contributions to any provident fund or Superannuation fund or any fund set up under the provisions of the Employees’ State Insurance Act, 1948, or any other fund for the welfare of such employees, which is chargeable to income tax under the head “Income from other sources” deductions so far, as may be in accordance with provisions of S 36(1) (va).
- In the case of income from machinery, plant or furniture belonging to the assessee and let on hire, if the income is not chargeable to income -- tax under the head “Profits and gains of business or profession or where an assessee lets on hire machinery, plant or furniture belonging to him and also buildings and the letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, the income from such letting, if it is not chargeable to income tax under the head “Profits and gains of business or profession”, deductions, so far as may, be in accordance with the provisions of clause (a), clause (3) of Section 30, Section 31 and subsections (1) and (2) of Section 32 and subject to the provisions of S 38.
- In the case of income in the nature of family pension, a deduction of a sum equal to thirty three and one third per cent of such income or fifteen thousand rupees, whichever is less.
- Any other expenditure (not being capital expenditure) laid out or used wholly and exclusively for the purpose of making or earning such income.

Check your progress 7

1. Any annuity due or commuted value of any annuity paid under section 280D is chargeable to tax under
 - a. Other sources
 - b. Business
 - c. Not taxable

3.9 Problem with Solution

Shri Hari Gopal is a member of parliament from Pune. During the previous year 2009-10 he had the following incomes:

1. As a member of parliament he received a salary of Rs. 8,000 p.m. & daily allowance of Rs. 40,000 for attending various sessions.
2. He held the following investments.
 - a. 10% Preference Shares in Pune Sugar works Ltd. , of the face value of Rs. 10,000.
 - b. 2,000 equity shares of Rs. 10 each in Tata Finlay Ltd. The company declared & paid a dividend at 15 % on 15th February, 2006.
 - c. A 10% fixed deposit of Rs. 20,000 is held by him in Indian Banks. Interest is credited annually.
 - d. He received dividend of Rs. 1,000 from a co-operative society.
3. He won Rs. 8,000 in crossword puzzles.
4. On 1st September, 2004 he purchased a plot of land for constructing his house. On account of shortage of funds, he could not get this house constructed and hence let out the plot at Rs. 300 per month from 1st November, 2005.
5. He has let machinery and furniture and also building to Mr. KrishnaGopalat a monthly rent of Rs. 10,000. He spent Rs. 3,000 on the repair of machinery, furniture and building during the previous year. Depreciation allowed in respect of these assets for the previous year was Rs. 20,000.

The Bank charged Rs. 40 as commission on collection of dividends from various companies.

Compute the taxable income of ShriHariGopal under the head 'Income from other Sources'.

Heads of Income –
Other Sources

Solution: Computation of income of ShriHariGopal for the A.Y. 2010-11

Income from other sources	Rs.
Salary as Member of Parliament	96,000
Daily allowance (exempted from tax)	----
Dividend on preference shares (exempted)	----
Final dividend on equity shares (exempted)	----
Dividend from co-operative society (No T.D.S.)	1,000
Interest on fixed deposit	2,000
Winning from crossword puzzles fully taxable w.e.f. 2003-04	8,000
Income from plot of land for 5 months	1,500
Rental income from machinery, furniture & building	1,20,000
Less: Admissible expenses:	Rs. 2,28,500
Bank commission on collection of dividend (Note 3)	Nil
Repair expenses	3,000
Depreciation	20,000 - 23,000
Income from other sources	2, 05,500

Note:

1. Winning from crossword puzzles is casual income, Exemption not allowed w.e.f. A.Y. 2003-04.
2. Daily allowance for attending sessions is exempt u/s 10(17).
3. Dividend on shares of Indian Companies is exempted from tax w.e.f. 2004-05 and therefore, the bank commission on collection of dividend is not allowed.

3.10 Let Us Sum Up

After going through this unit the student should have got a detailed insight of income from other sources.

This unit discusses about the last head of income i.e the income from other sources. This is the fifth and last head of income so any of the income which doesn't find its place in the other four heads of income is assessed under this head of income. Generally this head of income includes dividend income, winning from lottery, horse races, commission income and income from security. This head even includes the salary income of that person where the ship between the person of payee and payer is not of employee or employer. This is considered to be one of the complexed chapters as it includes income from varied heads and each of them has to be calculated differently. This chapter is considered to be difficult as there are so many types of income which a person can make and all those which don't fall in other four head has to come and considered under this head.

Certainly this unit is going to be of great help to the students of finance in understanding the concepts of this very chapter.

3.11 Answer for Check Your Progress

Check your progress 1

Answers: (1-a)

Check your progress 2

Answers: (1-b)

Check your progress 3

Answers: (1-a)

Check your progress 4

Answers: (1-b)

Check your progress 5

Answers: (1-b)

Check your progress 6

Answers: (1-b)

Check your progress 7

Answers: (1-a)

3.12 Glossary

1. **Tax free Government Securities** - Interest on such securities is neither included in total income nor it is taxed, i.e. it is fully exempted from tax.
2. **Less-Tax Government Securities** - Such securities are issued either by the Central or State Government. These are taxable securities, but no tax is deducted at source on such securities. Hence, the interest on such securities will not gross up.

3.13 Assignment

Discuss the scope of the 'Income from other sources'. State the deductions allowable.

3.14 Activities

Give at least 10 examples of income chargeable to tax under the head 'Income from other sources'.

3.15 Case Study

Study the different types of securities in the market and their taxation procedure and make a note.

3.16 Further Readings

1. Direct Taxes, Gupta and Ahuja.
2. The Economics of Taxation, Bernard Salanié, MIT Press, 1997
3. The Economics of Taxation, Henry Aaron and Michael J. Boskin, The Brookings Institution, 1980
4. Taxation: Its Principles and Methods, Luigi Cossa
5. Taxation and Finance, S.M. Shukla

Block Summary

So after going through this block you must have got sufficient exposure to business income, capital gains and income from other sources. The block contains one of the most important topics of income tax and even the most complexed one. But the efforts have been made by the writer to explain them in most simplest and easy language with sufficient illustrations. On close look of this block we will find that unit first discusses about the heads of income business or profession and house property. Here detailed discussion has been made on Income from Business or Profession, General Principles governing the computation of taxable income under the head ‘profits and gains of business or profession. On the other hand the second unit focuses on capital gains. Here detailed discussion has been made on basis of Charge (Sec 45), Chargeability of Tax, basis of charge, Long Term and Short Term, Seven Pillars of Capital Gain Treatment, Computation of Capital Gain. Lastly unit third discusses about the head of Income from other sources other sources, here discussion has been made on Income from other sources (Sec 56), Method of Accounting, Interest on securities, Basis of Charge, Kinds of Securities, Profit and Loss on sale of Securities, Tax upon Income from other sources, Problem with solution.

From the above discussion the most complexed topics have been explained very simply and easily with sufficient number of exercises by writer. This is certainly going to benefit the students who wish to opt finance and taxation as there area of specialisation and career in future.

Block Assignment

Short Answer Questions

1. Business
2. Profession
3. Vocation
4. Income chargeable under the head business.
5. Income from business or profession.
6. Seven Pillars of capital gain treatment.
7. Long term and short term.
8. Capital loss
9. Chargeability of Tax.
10. Basis of Charge (Sec 45).
11. Interest on securities.
12. Dividend
13. Deductions allowed from income from other sources.
14. Kinds of Securities.
15. Method of Accounting.

Long Answer Questions

1. What deduction is expressly disallowed under the head "Profit and Gains of Business or Profession"?
2. Explain the treatment and calculation of long term capital asset.
3. Discuss the types of income categorized under income from other sources.



“

*Education is something
which ought to be
brought within
the reach of every one.*

”

- Dr. B. R. Ambedkar



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TAXATION FOR MANAGERS

PGDF-204

BLOCK 3: CENTRAL SALES TAX AND RULES UNDER SALES TAX



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Ahmedabad**

TAXATION FOR MANAGERS



Knowledge Management and
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ROLE OF SELF INSTRUCTIONAL MATERIAL IN DISTANCE LEARNING

The need to plan effective instruction is imperative for a successful distance teaching repertoire. This is due to the fact that the instructional designer, the tutor, the author (s) and the student are often separated by distance and may never meet in person. This is an increasingly common scenario in distance education instruction. As much as possible, teaching by distance should stimulate the student's intellectual involvement and contain all the necessary learning instructional activities that are capable of guiding the student through the course objectives. Therefore, the course / self-instructional material are completely equipped with everything that the syllabus prescribes.

To ensure effective instruction, a number of instructional design ideas are used and these help students to acquire knowledge, intellectual skills, motor skills and necessary attitudinal changes. In this respect, students' assessment and course evaluation are incorporated in the text.

The nature of instructional activities used in distance education self-instructional materials depends on the domain of learning that they reinforce in the text, that is, the cognitive, psychomotor and affective. These are further interpreted in the acquisition of knowledge, intellectual skills and motor skills. Students may be encouraged to gain, apply and communicate (orally or in writing) the knowledge acquired. Intellectual-skills objectives may be met by designing instructions that make use of students' prior knowledge and experiences in the discourse as the foundation on which newly acquired knowledge is built.

The provision of exercises in the form of assignments, projects and tutorial feedback is necessary. Instructional activities that teach motor skills need to be graphically demonstrated and the correct practices provided during tutorials. Instructional activities for inculcating change in attitude and behavior should create interest and demonstrate need and benefits gained by adopting the required change. Information on the adoption and procedures for practice of new attitudes may then be introduced.

Teaching and learning at a distance eliminates interactive communication cues, such as pauses, intonation and gestures, associated with the face-to-face method of teaching. This is particularly so with the exclusive use of print media. Instructional activities built into the instructional repertoire provide this missing interaction between the student and the teacher. Therefore, the use of instructional activities to affect better distance teaching is not optional, but mandatory.

Our team of successful writers and authors has tried to reduce this.

Divide and to bring this Self Instructional Material as the best teaching and communication tool. Instructional activities are varied in order to assess the different facets of the domains of learning.

Distance education teaching repertoire involves extensive use of self-instructional materials, be they print or otherwise. These materials are designed to achieve certain pre-determined learning outcomes, namely goals and objectives that are contained in an instructional plan. Since the teaching process is affected over a distance, there is need to ensure that students actively participate in their learning by performing specific tasks that help them to understand the relevant concepts. Therefore, a set of exercises is built into the teaching repertoire in order to link what students and tutors do in the framework of the course outline. These could be in the form of students' assignments, a research project or a science practical exercise. Examples of instructional activities in distance education are too numerous to list. Instructional activities, when used in this context, help to motivate students, guide and measure students' performance (continuous assessment)



PREFACE

We have put in lots of hard work to make this book as user-friendly as possible, but we have not sacrificed quality. Experts were involved in preparing the materials. However, concepts are explained in easy language for you. We have included many tables and examples for easy understanding.

We sincerely hope this book will help you in every way you expect.

All the best for your studies from our team!



TAXATION FOR MANAGERS

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TAXATION FOR MANAGERS

BLOCK 3: CENTRAL SALES TAX AND RULES UNDER SALES TAX

UNIT 1

CENTRAL SALES TAX ACT 1956 03

UNIT 2

RULES UNDER CENTRAL SALES TAX ACT 1956 24

BLOCK 3: CENTRAL SALES TAX AND RULES UNDER SALES TAX

Block Introduction

This block covers the topic central sales. It discusses that central sales tax is one of the most important indirect tax as it is collected from the buyers by the seller and then deposited in the government account by the seller. Best efforts have been made to explain the topics in very easy language and in most interesting ways. Sufficient illustrations and pictures have been added to make the content more interesting and easy understandable. The whole block has been divided into two units. Unit one explain the Central sales tax act 1956. Here detailed discussion has been made on Definitions, Person liable to pay CST, Rates of CST, Sales turnover, Exemption from CST, Registration under CST Act. On the other hand unit second explain the Rules under central sales tax act 1956. It discusses about Rules under CST act, Certificate of Registration, Amendment or Cancellation of Certificate of Registration, Determination of Turnover Forms for Declaration, Illustrations

After study of this block the students will certainly be able to understand the concepts of central sales tax and how to make calculations in this regard.

Block Objective

After learning this Block, you will be able to understand:

- Meaning of Central sales tax
- Liability to pay CST
- How to determine the turnover
- CST exemption
- Registration process

Block Structure

Unit 1: Central sales tax act 1956

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UNIT 1: CENTRAL SALES TAX ACT 1956

Unit Structure

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1.0 Learning Objectives

After learning this unit, you will be able to understand:

- State the meaning and definitions of CST.
- Define a person liable to pay CST.

- Specify the rates of CST.
- Describe the determination of turnover.
- Discuss exemption from CST.
- Explain the process of registration under CST Act.

1.1 Introduction

A sale or purchase of goods shall be deemed to take place in the course of the export of the goods out of the territory of India only if the sale or purchase either occasions such export is affected by a transfer of documents of title to the goods after the goods have crossed the customs frontiers of India. In this unit we shall be discussing the detailed discussion on central sales tax.

Central sales tax is imposed at a fixed rate over and above the sales price on those goods that crosses the boundaries of state. Generally central sales tax is imposed at 3% imposed by the central government but collected by the state government. Let us learn these principles with the help of numerical problems.

1.2 Meaning and Definitions

This Act is called as the Central Sales Tax Act, 1956. It extends to the entire India. Following are some definitions according to this Act:

1.2.1 Definitions

1. **Sale** - "Sale", with its grammatical variations and cognate expressions, means any transfer of property in goods by one person to another person for cash or for deferred payment or for any other valuable consideration and includes a transfer of goods on the hire-purchase or other system of payment by instalments, but does not include a mortgage or hypothecation of or a charge or pledge on goods;

According to Supreme Court decision, what constitute sale?

The Supreme Court has laid down the test as to when a transaction becomes a sale. When there is a concurrence of the four elements then the transaction becomes a sale:

- There must be parties competent to contract
 - Mutual assent
 - A thing, the absolute or general property in which it is transferred from the seller to the buyer
 - A price consideration, in money paid or payable. These are the four elements which constitutes sale
2. **Goods** - “Goods” includes all materials, articles, commodities and all other kinds of movable property, but does not include [‘newspapers’] actionable claims, stocks, shares and securities

Explanation

The definition of “goods” is an inclusive one. It includes all materials, articles, commodities and all other kinds of movable property-with specified exceptions. The expression “goods” is defined to mean every kind of movable property. This will necessarily take within its sweep even intangible and incorporeal movable property. The definition of “Goods” though defined to include commodities ordinarily understood as movable property did not exclude other movable properties which would also fall within the meaning of that expression by virtue of their being movable properties (1967) 20 STC 115 (Mad).

3. **Declared Goods** - “Declared goods” means goods declared under Section 14 to be of special importance in Inter-State trade or commerce.
4. **Dealer** - ‘Dealer’ means any person who carries on (whether regularly or otherwise) the business of buying, selling, supplying or distributing goods, directly or indirectly, for cash, or for deferred payment, or for commission, remuneration or other valuable consideration and includes -
- A local authority, a body corporate, a company, any co-operative society or other society, club, firm, Hindu undivided family or other association of persons which carries on such business
 - A factor, broker, commission agent, del credere agent, or any other mercantile agent, by whatever name called and whether of the same description as herein before mentioned or not, who carries on the business of buying, selling, supplying or distributing, goods belonging to any principal whether disclosed or not

- An auctioneer who carries on the business of selling or auctioning goods belonging to any principal, whether disclosed or not and whether the offer of the intending purchaser is accepted by him or by the principal or a nominee of the principal

Explanation 1:

Every person who acts as an agent, in any State, of a dealer residing outside that State and buys, sells, supplies, or distributes, goods in the State or acts on behalf of such dealer as :

- A mercantile agent as defined in the Sale of Goods Act, 1930 (3 of 1930) or
- An agent for handling of goods or documents of title relating to goods or
- An agent for the collection or the payment of the sale price of goods or as a guarantor for such collection or payment and every local branch or office in a State of a firm registered outside, that State or a company or other body corporate, the principal office or headquarters whereof is outside that State, shall be deemed to be a dealer for the purposes of this Act.

Explanation 2:

A Government which, whether or not in the course of business, buys, sells, supplies or distributes goods, directly or otherwise, for cash or for deferred payment or for commission, remuneration, or other valuable consideration, shall, except in relation to any sale, supply or distribution of surplus, unserviceable or old stores or materials or waste products or obsolete or discarded machinery or parts or accessories thereof, be deemed to be a dealer for the purposes of this Act;

Note: (I) the word 'Person' is not defined under this Act.

5. Appropriate State - "Appropriate State" means:

- In relation to a dealer who has one or more places of business situated in the same State, that State
- In relation to a dealer who has 4 places of business situated in different states, every such State with respect to the place or places of business situated within its territory

6. Place of Business - "Place of business" includes:

- In any case where a dealer carries on business through an agent (by whatever name called), the place of business of such agent
- A warehouse, godown or other place where a dealer stores his goods and
- A place where a dealer keeps his books of account

7. Inter-State Sale - When is a sale or purchase of goods said to take place in the course of Inter-State trade or commerce.

A sale or purchase of goods shall be deemed to take place in the course of Inter-State trade or commerce if the sale or purchase -

- Occasions the movement of goods from one State to another State or
- Is effected by a transfer of documents of title to the goods during their movement from one State to another.

Explanation 1:

Where goods are delivered to a carrier or other bailee for transmission, the movement of the goods shall, for the purpose of clause (b), be deemed to commence at the time of such delivery and terminate at the time when delivery is taken from such carrier or bailee.

Explanation 2:

Where the movement of goods commences and terminates in the same State it shall not be deemed to be a movement of goods from one State to another State by reason merely of the fact that in the course of such movement the goods do not pass through the territory of any other State.

8. Sales outside the State - When is a sale or purchase of goods said to take place outside a State.

- a. Subject to the provisions contained in section 3, when a sale or purchase of goods is determined in accordance with sub-section (2) to take place inside a State, such sale or purchase shall be deemed to have taken place outside all other States.
- b. A sale or purchase of goods shall be deemed to take place inside a State if the goods are within the State:
 - In the case of specific or ascertained goods, at the time the contract of sale is made and

- In the case of unascertained or future goods, at the time of their appropriation to the contract of sale by the seller or by the buyer, whether assent of the other party is prior or subsequent to such appropriation.

Explanation:

Where there is a single contract of sale or purchase of goods situated at more places than one, the provisions of this sub-section shall apply as if there were separate contracts in respect of the goods at each of such places.

9. Sale during Import/Export - When is sale or purchase of goods said to take place in the course of import or export.

- a. A sale or purchase of goods shall be deemed to take place in the course of the export of the goods out of the territory of India only if the sale or purchase either occasions such export is effected by a transfer of documents of title to the goods after the goods have crossed the customs frontiers of India.
- b. A sale or purchase of goods shall be deemed to take place in the course of the import of the goods into the territory of India only if the sale or purchase either occasions such import is effected by a transfer of documents of title to the goods before the goods have crossed the customs frontiers of India.

Notwithstanding anything contained in sub-section (1), the last sale or purchase of any goods preceding the sale or purchase occasioning the export of those goods out of the Territory of India shall also be deemed to be in the course of such export, if such last sale or purchase took place after and was for the purpose of complying with, the agreement or order for or in relation to such export.

Check your progress 1

1. _____ means goods declared under Section 14 to be of special importance in Inter-State trade or commerce.
 - a. Declared goods
 - b. Important goods
 - c. Undeclared goods

1.3 Person Liable to Pay CST

The various person liabilities for paying CST are discussed below:

1.3.1 Liability to Tax on Inter-State Sales

Subject to the other provisions contained in this Act, every dealer shall, with effect from such date as the Central Government may, by notification in the Official Gazette, appoint, not being earlier than thirty days from the date of such notification, be liable to pay tax under this Act on all sales [of goods other than electrical energy] effected by him in the course of Inter-State trade or commerce during any year on and from the date so notified.

[Provided that a dealer shall not be liable to pay tax under this Act on any sale of goods which, in accordance with the provisions of sub-section (3) of Section 5, is a sale in the course of export of those goods out of the Territory of India].

[(1A) A dealer shall be liable to pay tax under this Act on a sale of any goods effected by him in the course of Inter-State trade or commerce notwithstanding that no tax would have been leviable (whether on the seller or the purchaser) under the sales tax law of the appropriate State if that sale had taken place inside that State].

[(2) Notwithstanding anything contained in sub-section (1) or sub-section (1A), where a sale of any goods in the course of Inter-State trade or commerce has either occasioned the movement of such goods from one State to another State or has been effected by a transfer of documents of title to such goods during their movement from one State to another, any subsequent sale during such movement effected by a transfer of documents of title to such goods.]

(A) To the Government or

(B) To a registered dealer other than the Government, if the goods are of the description referred to in sub-section (3) of section 8, shall be exempt from tax under this Act

Provided that no such subsequent sale shall be exempt from tax under this sub-section unless the dealer effecting the sale furnishes to the prescribed authority in the prescribed manner and within the prescribed time or within such further time as that authority may, for sufficient cause, permit,

- (a) A certificate duly filled and signed by the registered dealer from whom the goods were purchased containing the prescribed particulars in a prescribed form obtained from the prescribed authority; and
- (b) If the subsequent sale is made
 - (i) To a registered dealer, a declaration referred to in clause (a) of sub-section (b) of Section 8, or
 - (ii) To the Government, not being a registered dealer, a certificate referred to in clause (b) of sub-section (4) of Section 8.

Provided further that it shall not be necessary to furnish the declaration or, the certificate referred to in clause (b) of the preceding proviso in respect of a subsequent sale of goods if

- (a) The sale or purchase of such goods is, under the sales tax law of the appropriate State, exempt from tax generally or is subject to tax generally at a rate which is lower than [four per cent] (whether called a tax or fee or by any other name) and
- (b) The dealer affecting such subsequent sale proves to the satisfaction of the authority referred to in the preceding proviso that such sale is of the nature referred to in clause (A) or clause (B) of this sub-section.

1.3.2 Burden of Proof Etc. in Case of Transfer of Goods Claimed Otherwise than by Way of Sale

Where any dealer claims that he is not liable to pay tax under this Act, in respect of any goods, on the ground that the movement of such goods from one State to another was occasioned by reason of transfer of such goods by him to any other place of his business or to his agent or principal, as the case may be and not by reason of sale, the burden of proving that the movement of those goods was so occasioned shall be on that dealer and for this purpose he may furnish to the assessing authority, within the prescribed time or within such further time as the authority may, for sufficient cause, permit, a declaration.

If the assessing authority is satisfied after making such inquiry as he may deem necessary that the particulars contained in the declaration furnished by a dealer under subsection (1) are true, he may, at the time of, or at any time before, the assessment of the tax payable by the dealer under this Act, make an order to that effect and thereupon the movement of goods to which the declaration relates

shall be deemed for the purposes of this Act to have been occasioned otherwise than as a result of sale.

Check your progress 2

1. A dealer shall not be liable to pay tax under this Act on any sale of goods which, in accordance with the provisions of sub-section (3) of Section 5, is a sale in the course of export of those goods _____Territory of India.
 - a. out of the
 - b. within

1.4 Rates of CST

Rates of tax on sales in the course of Inter-State trade or commerce.

- (1) Every dealer, who in the course of Inter-State trade or commerce
 - (a) Sells to the Government any goods or
 - (b) Sells to a registered dealer other than the Government goods of the description referred to in sub-section (3); shall be liable to pay tax under this Act, which shall be [‘four per cent’] of his turnover.
- (2) The tax payable by any dealer on his turnover in so far as the turnover or any part thereof relates to the sale of goods in the course of Inter-State trade or commerce not falling within sub-section (1) –
 - (a) In the case of declared goods, shall be calculated [at twice the rate] applicable to the sale or purchase of such goods inside the appropriate State and
 - (b) In the case of goods other than declared goods, shall be calculated at the rate of [ten per cent] or at the rate applicable to the sale or purchase of such goods inside the appropriate State, whichever is higher; and for the purpose of making any such calculation any such dealer shall be deemed to be a dealer liable to pay tax under the sales tax law of the appropriate State notwithstanding that he, in fact, may not be so liable under that law.

(2A) Notwithstanding anything contained in sub-section (1A) of section 6 or sub-section (1) [or clause (b) of sub-section (2)] of this section, the tax payable under this Act by a dealer on his turnover in so far as the turnover or any part thereof relates to the sale of any goods, the sale or, as the case may be, the purchase of which is under the sales tax law of the appropriate State, exempt from tax generally or subject to tax generally at a rate which is lower than [four per cent.] (Whether called a tax or fee or by any other name, shall be nil or, as the case may be, shall be calculated at the lower rate.

Explanation: For the purposes of this sub-section a sale or purchase of any goods shall not be deemed to be exempt from tax generally under the sales tax law of the appropriate State if under that law the sale or purchase of such goods is exempt only in specified circumstances or under specified conditions or the tax is levied on the sale or purchase of such goods at specified stages or otherwise than with reference to the turnover of the goods.

- (3) The goods referred to in clause (b) of sub-section (1):
- a. Are goods of the class or classes specified in the certificate of registration of the registered dealer purchasing the goods as being intended for re-sale by him or subject to any rules made by the Central Government in this behalf for use by him in the manufacture or processing of goods for sale or in mining or in the generation or distribution of electricity or any other form of power;
 - b. Are containers or other materials specified in the certificate of registration of the registered dealer purchasing the goods, being containers or materials intended for being used for the packing of goods for sale;
 - c. Are containers or other materials used for the packing of any goods or classes of goods specified in the certificate of registration referred to in 8* * clause (b) or for the packing of any containers or other materials specified in the certificate of registration referred to in clause (c).

Rates of CST:

- (4) The provisions of sub-section (1) shall not apply to any sale in the course of Inter-State trade or commerce unless the dealer selling the goods furnishes to the prescribed authority in the prescribed manner -

- (a) A declaration duly filled and signed by the registered dealer to whom the goods are sold containing the prescribed particulars in a prescribed form obtained from the prescribed authority; or
- (b) If the goods are sold to the Government, not being a registered dealer, a certificate in the prescribed form duly filled and signed by duly authorised officer of the Government] :

[Provided that the declaration referred to in clause (a) is furnished within the prescribed time or within such further time as that authority may, for sufficient cause, permit].

- (5) Notwithstanding anything contained in this section, the State Government may, if it is satisfied that it is necessary so to do in the public interest, by notification in the Official Gazette and subject to such conditions as may be specified therein, direct,
 - (a) That no tax under this Act shall be payable by any dealer having his place of business in the State in respect of the sales by him, in the course of Inter-State trade or commerce, from any such place of business to any such goods or classes of goods as may be specified in the notification, or that the tax on such sales shall be calculated at such lower rates than those specified in sub-section (1) or sub-section (2) as may be mentioned in the notification,
 - (b) That in respect of all sales of goods or sales of such classes of goods as may be specified in the notification, which are made, in the course of Inter-State trade or commerce, by any dealer having his place of business in the State or by any class of such dealers as may be specified in the notification to any person or to such class of persons as may be specified in the notification, no tax under this Act shall be payable or the tax on such sales shall be calculated at such lower rates than those specified in sub-section (1) or sub-section (2) as may be mentioned in the notification].

Rates of Tax on Inter-State Sales

Central Sales Tax
Act 1956

SI. No.	Nature of Sales or To Whom Sales is Made	Percentage of Tax	Conditions
1.	Sale to Government.	4%	(i) Sales made by Registered dealer and; (ii) Duly obtaining Form D from Government officials.
2.	Sale to Registered Dealers.	4%	(i) Sales made by one registered dealer to another registered dealer. (ii) Purchased material are prescribed in Registration certificate. (iii) Purchase is made by purchaser for Re-sales, Manufacture or Packing. (iv) The seller has obtained Form 'C' from purchaser.
3.	On Sale of Declared Goods to Unregistered Dealer.	Double of applicable Rate.	
4.	On Sale of Goods other than Declared Goods to Unregistered Dealers.	10% or Rate of Tax in the State, whichever is higher.	If particular goods attracts no CST or less than 4%, than the Rate of CST shall be: 0% or 4% which- ever is lower but not 10%.

Check your progress 3

1. Rate of tax in case of a registered dealer is chargeable @ _____.
 - a. 3%
 - b. 4%
 - c. Not taxable

1.5 Sales Turnover, Exemption from CST

1.5.1 Meaning

“Turnover” used in relation to any dealer liable to tax under this Act means the aggregate of the sale prices received and receivable by him in respect of sales of any goods in the course of Inter-State trade or commerce made during any prescribed period [and determined in accordance with the provisions of this Act and the rules made there under.

Ingredients of turnover:

Turnover means:

- a. The aggregate of the sale prices
- b. The sale prices may have already been received by the dealer or may only be receivable by him
- c. The sale prices must be in respect of sale of goods in the course of Inter-State trade or commerce
- d. They must relate to the period prescribed under the rules and
- e. They must be determined in accordance with the provisions of the Central Sales Tax Act, section 8-A and rules made there under.

Under the definition of Turnover in Section 2 (J) of the Central Sales Tax Act the conjunction is “and” not “or” between the words “sale prices received and “sale prices receivable”. The two expressions “sale prices received and “sale price receivable” have in their background reference to the two well-known systems of keeping accounts, namely the “cash system” and “Mercantile system.” In order to determine “turnovers” under the Central Sales Tax Act the conjunction “stands” between the expressions sale prices “received” and “receivable” in the definition portion, intends only the mercantile system of keeping accounts as the basis for

such determination. For the parties keeping a cash system of accounts, determination of turnover would still be inclusive of unrealised sales [(1977) 37 STC 404 (Cal)].

Where an assessee claimed exclusion of freight charges in computation of taxable turnover in case of invoice mentioning the controlled price with added excise duty and giving credit for railway freight and a net price resulting in what is called a net price. Works siding is worked out with added Central Sales Tax, packing charges with Sales Tax thereon and deposit to cover Sales Tax on freight, if any, it was held that assessee cannot get the benefit of such deduction of freight as was sought to be claimed. AIR 1993 S.C. 123 TVL? AmcoCement Distribution Co, Put. Ltd. V. State of Tamil Nadu. In the case the Rule governing being Rule 6 of T.N. General Sales Tax Rules required such freight charges to be excluded. Further the conditions of the contract were read in the light of the cement control order governing the case.

It was observed the whole control order proceeds on the footing that the freight charges are to be met by the producer and that he was entitled to a consolidated price irrespective of the freight incurred and that the sale price on the terms of the Central Sales Tax Act could only be the controlled price as fixed by the Cement Control Order. On facts since the invoice contained all details instead of net price FOR and works siding and dispatched the goods under freight to pay.

1.5.2 Determination of Turnover

1. In determining the turnover of a dealer for the purposes of this Act, the following deductions shall be made from the aggregate of the sale prices, namely :

a. The amount arrived at by applying the following formula

$$\frac{\text{Rate of tax X aggregate of sale prices}}{100 \text{ plus rate of tax}}$$

Provided that no deduction on the basis of the above formula shall be made if the amount by way of tax collected by a registered dealer, in accordance with the provisions of this Act, has been otherwise deducted from the aggregate of sale prices.

Explanation:

Where the turnover of a dealer is taxable at different rates, the aforesaid formula shall be applied separately in respect of each part of the turnover liable to a different rate of tax;

b. The sale price of all goods returned to the dealer by the purchasers of such goods

- Within a period of three months from the date of delivery of the goods, in the case of goods returned before the 14th day of May, 1966;
- Within a period of six months from the date of delivery of the goods, in the case of goods returned on or after the 14th day of May, 1966:

Provided that satisfactory evidence of such return of goods and of refund or adjustment in accounts of the sale price thereof is produced before the authority competent to assess or, as the case may be reassess the tax payable by the dealer under this Act and

c. Such other deductions as the Central Government may, have regard to the prevalent market conditions, facility of trade and interests of consumers prescribe.

2. Save as otherwise provided in sub-section (1), in determining the turnover of a dealer for the purposes of this Act, no deduction shall be made from the aggregate of the sale prices.’

1.5.3 Exemption from CST Nature of Exemption

The ideabehind sub-section (2-A) of section 8 of the Central Sales Tax Act, is to exempt the sale purchase of goods from the Central Sales Tax where the sale or purchase of such goods is exempt generally under the State Sales Tax Law. One must give due regard and attach the meaning to the expression ‘generally which occurs in the sub-section and which expression has been defined in the explanation. If the said expression had not been there, it could probably have been possible to argue that in as much as the goods sold by a particular manufacturer-dealer are exempt from the State tax in his hands; they must equally be exempt under the Central Act. But sub-section (2-A) requires specifically that such exemption must be a general exemption and not an exemption operative in

specified circumstances or under specified conditions. Exemption provided by Government Order No. 159 is not with reference to goods but with reference to the industrial unit. So long as it is (i) a large or medium scale industry and (ii) it manufactures and sells goods within the five years of its going into production, the sale of such goods is exempt irrespective of the nature or classification of goods.

Similar goods may be manufactured by another unit but if it does not satisfy the above two requirements, the goods manufactured and sold by it would not be entitled to exemption from tax. Indeed, the goods manufactured by that every unit would not be eligible for exemption if they are manufactured after the expiry of five years from the date it goes into production and/or sells them beyond the said period.

The period of exemption may also vary from unit to unit depending on the date of commencement of production in each unit. So goods exempted under Government Order No. 159 are not exemption from tax generally under the State Sales Tax enactment. Therefore, the exemption granted under the aforesaid government order does not satisfy the requirements of Section 8 (2-A).

Section 8 (2-A) speaks of sale or purchase of goods being exempt generally under the State Sales Tax enactment, it does not speak of exemption qua the dealer, much less qua the unit manufacturing such goods. The exemption notification issued by the Jammu and Kashmir Government granted the exemption qua the industrial unit manufacturing the goods and the period within which they are manufactured and sold and not qua the goods.

The contrary judgment of the High Court suffers from an error apparent on the face of the record and it is necessary that this error is rectified. [C.S.T. V. Pine Chemicals Ltd.(1995) 1 SCC 58], Constitution 46th Amendment by insertion of Article 366 (29A) has widened the definition to include many transactions resembling sales or purchases within the sweep of sales or purchase. CST has not in terms mentioned those transactions.

The S.C. however in 1992-85 STC 422 and 1991-83 STC 276 has indicated that such transactions as reflected in State laws may be considered as covered in CST Act without requiring any amendment in the statute.

Check your progress 4

1. Aggregate of sale price by a dealer is known as _____.
 - a. Turnover
 - b. Sales
 - c. profit

1.6 Registration under CST Act

Registration of Dealer

CD Every dealer liable to pay tax under this Act shall, within such time as may be prescribed for the purpose, make an application for registration under this Act to such authority in the appropriate State as the Central Government may, by general or special order, specify and every such application shall contain such particulars as may be prescribed.

[(2) Any dealer liable to pay tax under the sales tax law of the appropriate State, or where there is no such law in force in the appropriate State or any part thereof, any dealer having a place of business in that State or part, as the case may be, may, notwithstanding that he is not liable to pay tax under this Act, apply for registration under this Act to the authority referred to in sub-section (1) and every such application shall contain such particulars as may be prescribed.

Explanation: For the purpose of this sub-section, a dealer shall be deemed to be liable to pay tax under the sales tax law of the appropriate State notwithstanding that under such law a sale or purchase made by him is exempt from tax or a refund or rebate of tax is admissible in respect thereof]

[(2A) Where it appears necessary to the authority to whom an application is made under sub-section (1) or sub-section (2) so to do for the proper realisation of the tax payable under this Act or for the proper custody and use of the forms referred to in clause (a) of the first proviso to sub-section (2) of Section 6 or sub-section (/) of section 6A or clause (a) of sub-section (4) of Section 8, he may, by an order in writing and for reasons to be recorded therein, impose as a condition for the issue of a certificate of registration a requirement that the dealer shall furnish in the prescribed manner and within such time as may be specified in the order such security as may be so specified, for all or any of the aforesaid purposes].

(3) If the authority to whom an application under sub-section (1) or sub-section (2) is made is satisfied that the application is in conformity with the provisions of this Act and the rules made there under [and the condition, if any, imposed under sub-section (2A), has been complied with], he shall register the applicant and grant to him a certificate of registration in the prescribed form which shall specify the class or classes of goods for the purpose of subsection (1) of section 8.

[(3A) Where it appears necessary to the authority granting a certificate of registration, under this section so to do for the proper realisation of tax payable under this Act or for the proper custody and use of the forms referred to in sub-section (2A), he may, at any time while such certificate is in force, by an order in writing and for reasons to be recorded therein, require the dealer, to whom the certificate has been granted to furnish within such time as may be specified in the order and in the prescribed manner such security, or, if the dealer has already furnished any security in pursuance of an order under this sub-section or sub-section (2A), such additional security, as may be specified in the order, for all or any of the aforesaid purposes.

[(3B) No dealer shall be required to furnish any security under sub-section (2A) or any security or additional security under sub-section (3A) unless he has been given an opportunity of being heard.

(3BB) The amount of security which a dealer may be required to furnish under sub-section (2A) or sub-section (3A) or the aggregate of the amount of such security and the amount of additional security which he may be required to furnish under sub-section (3A), by the authority, referred to therein, shall not exceed –

- (a) In the case of a dealer other than a dealer who has made an application, or who has been registered in pursuance of an application, under sub-section (2), a sum equal to the tax payable under this Act, in accordance with the estimate of such authority, on the turnover of such dealer for the year in which such security or, as the case may be, additional security is required to be furnished; and
- (b) In the case of a dealer who has made an application, or who had been registered in pursuance of an application, under sub-section (2), a sum equal to the tax leviable under this Act, in accordance with the estimate of such authority on the sales to such dealer in the course of Inter-State trade or commerce in the year in , which such security or, as the case may be,

additional security is required to be furnished, had such dealer been not registered under this Act].

(3C) Where the security furnished by a dealer under sub-section (2A) or sub-section (3A) is in the form of a surety bond and the surety becomes insolvent or dies, the dealer shall, within thirty days of the occurrence of any of the aforesaid events, inform the authority granting the certificate of registration and shall within ninety days of such occurrence furnish a fresh surety bond or furnish in the prescribed manner other security for the amount of the bond.

(3D) The authority granting the certificate of registration may by order and for good and sufficient cause forfeit the whole or any part of the security furnished by a dealer -

- (a) For realising any amount of tax or penalty payable by the dealer;
- (b) If the dealer is found to have misused any of the forms referred to in sub-section (2A) or to have failed to keep them in proper custody-

Provided that no order shall be passed under this sub-section without giving the dealer an opportunity of being heard.

(3E) Whereby reason of an order under sub-section (3D), the security furnished by any dealer is rendered insufficient, he shall make up the deficiency in such manner and within such time as may be prescribed.

(3F) The authority issuing the forms referred to in sub-section (2A) may refuse to issue such forms to a dealer who has failed to comply with an order under that sub-section or subsection (3A), or with the provisions of sub-section (3C) or sub-section (3E), until the dealer has complied with such order or such provisions, as the case may be.

(3G) The authority granting a certificate of registration may, on application by the dealer to whom it has been granted, order the refund of any amount or part thereof deposited by the dealer by way of security under this section, if it is not required for the purposes of this Act.

(3H) Any person aggrieved by an order passed under sub-section (2A), sub-section (3A); sub-section (3D) or sub-section (3d) may, within thirty days of the service of the order on him, but after furnishing the security, prefer, in such form and manner as may be prescribed, an appeal against such order to such authority (hereafter in this section referred to as the "appellate authority") as may be prescribed:

Provided that the appellate authority may, for sufficient cause, permit such person to present the appeal -

- (a) After the expiry of the said period of thirty days; or
- (b) Without furnishing the whole or any part of such security.

(3) The procedure to be followed in hearing any appeal under sub-section (3H) and the fees payable in respect of such appeals shall be such as may be prescribed.

(3J) The order passed by the appellate authority in any appeal under sub-section (3H) shall be final].

A certificate of registration granted under this section may -

- (a) Either on the application of the dealer to whom it has been granted or, where no such application has been made, after due notice to the dealer, be amended by the authority granting it if he is satisfied that by reason of the registered dealer having changed the name, place or nature of his business or the class or classes of goods in which he carries on business or for any other reason the certificate of registration granted to him requires to be amended; or
- (b) Be cancelled by the authority granting it where he is satisfied, after due notice to the dealer to whom it has been granted, that he has ceased to carry on business [or has ceased to exist or has failed without sufficient cause, to comply with an order under sub-section (3A) or with the provisions of sub-section (3C) or subsection (3E) or has failed to pay any tax or penalty payable under this Act], or in the case of a dealer registered under sub-section (2) has ceased to be liable to pay tax under the sales tax law of the appropriate State or for any other sufficient reason.

A registered dealer may apply in the prescribed manner not later than six months before the end of a year to the authority which granted his certificate of registration for the cancellation of such registration and the authority shall, unless the dealer is liable to pay tax under this Act, cancel the registration accordingly and where he does so, the cancellation shall take effect from the end of the year.

Check your progress 5

1. No dealer shall be required to _____ under sub-section (2A) or any security or additional security under sub-section (3A) unless he has been given an opportunity of being heard.
 - a. furnish any record
 - b. furnish any security

1.7 Let Us Sum Up

In this unit we have discussed that what is considered as sale under central sales tax act. It explains what sales under sales tax act are. It even discusses about a sale or purchase of goods shall be deemed to take place in the course of the import of the goods into the territory of India only. The later portions talks about what are goods under this act. It says that “Goods” includes all materials, articles, commodities and all other kinds of movable property, but does not include [‘newspapers’] actionable claims, stocks, shares and securities. It even talks about declared and undeclared goods. Discussion also included place of business. This unit has in very detail talk about the calculations of central sales tax, regarding registration procedure of dealers etc.

This unit is certainly going to be of great help for the future tax experts.

1.8 Answer for Check Your Progress

Check your progress 1

Answers: (1-b)

Check your progress 2

Answers: (1-a)

Check your progress 3

Answers: (1-b)

Check your progress 4

Answers: (1-a)

Check your progress 5

Answers: (1-b)

1.9 Glossary

1. **Input Tax** - Term used in connection with VAT to denote the tax embodied in purchases made by a trader or entrepreneur who will usually be able to obtain a credit for the tax that his suppliers have paid on the goods supplied to him which form his "inputs".
2. **Indirect Tax** - Tax imposed on certain transactions, goods or events. Examples include VAT, sales tax, excise duties, stamp duty, services tax, registration duty and transaction tax

1.10 Assignment

Give the meaning and definitions of CST.

1.11 Activities

Explain the registration under CST Act.

1.12 Case Study

Study the different types of forms for registration and declaration of CST and make notes.

1.13 Further Readings

1. The Economics of Taxation, Bernard Salanié, MIT Press, 1997.
2. The Economics of Taxation, Henry Aaron and Michael J. Boskan, The Brookings Institution, 1980.

UNIT 2: RULES UNDER CENTRAL SALES TAX ACT 1956

Unit Structure

- 2.0 Learning Objectives**
- 2.1 Introduction**
- 2.2 Rules under CST act**
- 2.3 Certificate of Registration**
- 2.4 Amendment or Cancellation of Certificate of Registration**
- 2.5 Determination of Turnover**
- 2.6 Forms for Declaration**
- 2.7 Illustrations**
- 2.8 Let Us Sum Up**
- 2.9 Answer for Check Your Progress**
- 2.10 Glossary**
- 2.11 Assignment**
- 2.12 Activities**
- 2.13 Case Study**
- 2.14 Further Readings**

2.0 Learning Objectives

After learning this unit, you will be able to understand:

- State the rules under CST act.
- Define certificate of registration.
- Explain the amendment or cancellation of certificate of registration.
- Describe the determination of turnover.
- Identify forms for declaration.

2.1 Introduction

The Central Sales-Tax (Registration And Turnover) Rules, 1957 S.R.O. 644, Dated 28th February, 1957: In exercise of the powers conferred by sub-section (1) of Section 13 of the Central Sales Tax Act, 1956 (74 of 1956), the Central Government hereby makes certain rules. They are discussed in this unit.

In this unit we are going to study the various rules under the central sales tax. What are the provisions under CST regarding amendment or cancellation of certificate of registration. In this block we will also be discussing the process or method of determination of turnover for sales tax purpose. The readers will also be introduced with the various kinds of forms that are used for sales tax purpose. The purpose of each type of these forms will also be detailed to the readers in detail.

2.2 Rules under CST Act

1. These rules may be called the Central Sales-tax (Registration and Turnover) Rules, 1957.
 2. In these rules, unless the context otherwise requires –
 - a. “Act” means the Central Sales-Tax Act, 1956; [(aa) “Authorised officer” means an officer authorised by the Central Government under Clause (b) of sub-section (4) of Section 8]; [(aaa) “Company” means a company as defined in Section of the Companies Act, 1956 (1 of 1956) and includes a foreign company within the meaning of Section 591 of that Act];
 - b. “Form” means a form appended to these rules;
 - c. “Notified authority” means the authority specified under sub-section (1) of section 7; [(cc) “Prescribed authority” means the authority empowered by the Central Government under [sub-section (2) of Section 9], or the authority prescribed by a State Government under Clause (e) of sub-section (4) of Section 13, as the case may be];
 - d. “Section” means a section of the Act;
- “Warehouse” means any enclosure, building or vessel in which a dealer keeps a stock of goods for sale.

Check your progress 1

1. _____” means any enclosure, building or vessel in which a dealer keeps a stock of goods for sale.
 - a. Warehouse
 - b. business

2.3 Certificate of Registration

An application for registration under Section 7 shall be made by a dealer to the notified authority in Form A and shall be -

- a. Signed by the proprietor of the business, or, in the case of a firm, by one of its partners, or, in the case of Hindu undivided family, by the karta or manager of the family, or, in the case of a company [***] by a director, managing agent or principal officer thereof, or, in the case of a Government, by an officer duly authorised by that Government, or, in the case of any other association of individuals, by the principal officer managing the business; and
 - b. Verified in the manner provided in the said Form A.
1. Where a dealer has more than one place of business within a State, he shall make a single application in respect of all such places, name in such application one of such places as the principal place of business for the purposes of these rules and submit such application to the notified authority specified in respect of the principal place of business so named:

Provided that any place so named shall not in any case be different from the place, if any, declared by him to be the principal place of business, by whatever name called, under the general Sales-tax law of the State.

2. (1) An application for registration under sub-section (1) of Section 7 shall be made not later than thirty days from the date on which the dealer becomes liable to pay tax under the Act.

(2) An application for registration under sub-section (2) of Section 7 may be made at any time after the commencement of the Act.

(3) A fee of [rupees twenty-five] shall be payable in respect of every application for registration under sub-rule (1) or sub-rule (2); and such fee may be paid in the form of court-fee stamps affixed to such application.

3. (1)When the notified authority is satisfied, after making such enquiry as it thinks necessary, that the particulars contained in the application are correct and complete [and the fee-referred to in sub-rule (3) of rule 4 has been paid], it shall register the dealer and grant him a certificate of registration in Form Band also a copy of such certificate for every place of business within the State other than the principal place of business mentioned therein.

(2) When the said authority is not satisfied that the particulars contained in the application are correct and complete, where the fee referred to in sub-rule (3) of rule 4 has not been paid, he shall reject the application for reasons to be recorded in writing

Provided that before the application is rejected the applicant shall be given an opportunity of being heard in the matter and, as the case may be, of correcting and completing the said particulars for-complying with the requirements of sub-rule (3) of rule 4].

4. The certificate of registration granted under sub-rule (1) of rule 5 shall be kept at the principal place of business mentioned in such certificate and a copy of such certificate under the said sub-rule shall be kept at every place of business within the State other than the principal place of business, mentioned in such certificate.

5. (1) Where a dealer desires the certificate of registration granted to him under these rules to be amended, he shall submit an application for this purpose to the notified authority setting out the specific matters in respect of which he desires such amendment and the reasons therefore, together with the certificate of registration and the copies thereof, if any, granted to him; and such authority may, if satisfied with the reasons given make such amendments, as it thinks necessary in the certificate of registration and the copies thereof, if any, granted to him.

(2)The provisions of rule 6 shall apply in relation to such amended certificate and copies thereof, as they apply in relation to the original certificate and copies thereof.

6. (1)Where the certificate of registration granted to a dealer is lost, destroyed, defaced or mutilated, he may on application made in this behalf to the

notified authority and on payment of a fee of a [rupees five] obtained a duplicate copy of such certificate.

(2) The fee payable under sub-rule (7) shall be paid in the form of [court-fee stamps].

Check your progress 2

1. An application for registration under Section 7 shall be made by a dealer to the notified authority in _____.
 - a. Form B
 - b. Form A
 - c. Form C

2.4 Amendment or Cancellation of Certificate of Registration

1. A notified authority shall, before amending or canceling, as the case may be, the certificate of registration of a dealer under sub-section (4) of Section 7, give him an opportunity of being heard in the matter.
2. If the certificate of registration is proposed to be amended, the dealer shall forthwith produce to the notified authority the certificate of registration and the copies thereof, if any, granted to him, for having them amended.
3. If the certificate of registration is cancelled, the dealer shall forthwith surrender to the notified authority the certificate of registration and the copies thereof, if any, granted to him.

If any dealer desires to apply under sub-section (5) of Section 7 for cancellation of his registrations, he shall submit within the time specified in that sub-section to the notified authority an application in that behalf together with the certificate of registration and copies thereof, if any, granted to him; and such application shall be dealt with in accordance with the provisions of that sub-section.

authority may, having regard to the circumstances of the case, fix. Such identity bond shall be furnished by the selling dealer to the notified authority of his State if a duly completed form of declaration received by him is lost, whether such loss occurs while it is in his custody or while it is in transit to the notified authority of his State].

[Provided that where more than one form of declaration is lost, the purchasing dealer or the selling dealer, as the case may be, may furnish one such indemnity bond to cover all the forms of declarations so lost].

Where a declaration form furnished by the dealer purchasing the goods or the certificate furnished by the Government has been lost, the dealer selling the goods may demand from the dealer who purchased the goods or, as the case may be, from the Government which purchased the goods, duplicate of such form or certificate and the same shall be furnished with the following declaration recorded in red ink and signed by the dealer or authorised officer of the Government, as the case may be, on all the three portions of such form or certificate -

“I hereby declare that this is the duplicate of the declaration form/certificate No. signed on and issued to who is a registered dealer of State and whose registration certificate No. is made

[(4) The certificate referred to in sub-section (2) of Section 6 shall be in Form E-I or Form E-II, as the case may be.

[(5) The declaration referred to in sub-section (1) of Section 6-A shall be in Form F].

[Provided that a single declaration may cover transfer of goods, by a dealer, to any other place of his business or to his agent or principal, as the case may be, effected during a period of one calendar month

Provided further that if the space provided in Form F is not sufficient for making entries, the particulars specified in Form F may be given in separate annexure attached to that form so long as it is indicated in the form that the annexure form part thereof and every such annexure is, also signed by the person signing the declaration in Form F

Provided also that form in force before the commencement of the Central Sales-tax (Registration and Turnover) (Second Amendment) Rules, 1973, may

continue to be used up to 31st day of December, [1980] with suitable modifications].

[(6) Forms C referred to in sub-rule (1), or as the case may be, Form F referred to in sub-rule (5) shall be the one obtained by the purchasing dealer or, as the case may be, the transferee in the State in which the goods covered by such form are delivered.

Explanation : Where, by reason of the purchasing dealer not being registered under Section 7 in the State in which the goods covered by Form C referred to in sub-rule (1) are delivered, he is not able to obtain the said form in the State in which he is registered under the said section].

[(7) The declaration in Form C or in Form F or the certificate in Form E-I or Form E-II shall be furnished to the prescribed authority up to the time of assessment by the first assessing authority :

Provided that if the prescribed authority is satisfied that the person concerned was prevented by sufficient cause from furnishing such declaration or certificate with the aforesaid time, the authority may allow such declaration or certificate to be furnished within such further time as that authority may permit].

(8) (a) The person referred to in Clause (a) sub-rule (1) of rule 3 shall alone be competent to sign the declaration in Form C or Form F or the certificate in Form E-II:

[Provided that where such person is a proprietor of any business or a partner of a firm or Karta or manager of a Hindu undivided family, any other person authorised by him in writing may also sign such declaration or certificate].

Provided further that in the case of [a company, such declaration or certificate can also be signed by any other officer of the company or under any other special or general resolution of the company or under a resolution passed by the Board of Directors of the Company to authenticate any document on behalf of such company].

(b) 'Such person shall signify on such declaration or certificate his status and shall make verification in the manner provided in such declaration or certificate.

[(a) The provisions of sub-rule (2) and sub-rule (3) shall, with necessary modifications, apply to the declaration in Form F or the certificate in Form E-I or Form E-II]

[(b) The provisions of the second and third proviso to sub-rule (1) shall with necessary modifications, apply to certificate in Form E-I or Form E-II].

[10] (a) A dealer may, in support of his claim that he is not liable to pay tax under this Act in respect of any goods on the ground that the sale of such goods is a sale in the course of export of those out of the territory of India within the meaning of sub-section (3) of Section 5, furnish to the prescribed authority a certificate in Form "H" duly-filled and signed by the exporter along with the evidence of export of such goods.

(b) The provisions of the rules framed by the respective State Governments under subsection (3), (4) and (5) of Section 13 relating to the authority from whom and the conditions subject to which any form of certificate in Form "H" may be obtained, the manner in which such form shall be kept in custody and records relating thereto maintained and the manner in which any such form may be used and any such certificate may be furnished in so far they apply to declaration in Form C prescribed under these rules shall mutatis mutandis apply to certificate in Form H].

Note: Furnishing of Photostat copies of declaration form as contemplated in Rule 12 (3) is not compliance with Rule 12 (3). Duplicates alone would sub-serve the compliance and ought to be pursued. 1997 - 104 STC 75 (SC) Delhi Automobiles P. Ltd. V. CST.

[13. Prescription of goods for certain purchases: The goods referred to in Clause (b) of sub-section (3) of Section 8 which a registered dealer may purchase shall be goods intended for use by him as raw material processing materials, machinery, plant, equipment, tools, stores, spare parts, accessories, fuel or lubricants, in the manufacture or processing of goods for sale or in mining, or in the generation or distribution of electricity or any other form of power.

[14. If any person commits abreach of any of these rules, he shall be punishable with fine which may extend to five hundred rupees and when the offence is a continuing offence, with a daily fine which may extend to fifty rupees for every day during which the offence continues].

Status of person nominated

Place

Date

Enter here on of the following as may be applicable:

(a) the guardian/trustee or on behalf of

.....

(b) a Hindu undivided family known as

.....

(c) an association/club/society known as

.....

(d) a firm known as

.....

(e) a private limited company known as

.....

(f) public limited company/co-operative society known as

.....

The declaration shall be signed in the case of -

(i)	a Hindu undivided family	...	by its manager
(ii)	an association, club or society	...	by its President or Chairman and the Secretary
(iii)	a firm	...	by the partners having a total share of not less than 50 per cent.
(iv)	a private limited company	...	Byall its Directors or where there are no Directors by the authorised representative of the Company nominated by the Chairman.
(v)	a public limited company or co-operative society.		by the Managing Agents or where there are no Managing Agents, the Managing Directors or the Chairman of the Board of Directors and the Secretary.

[FORM I (B)]

[See Rule 4A (1)]

Register of sales made on declaration under sub-section (4) of Section 8 and transfer of goods under Section 6A against declaration under sub-section (1) of Section 6A and showing particulars of certificates under sub-section (2) of Section 6 of the Central Sales Tax Act, 1956 against which the goods sold were purchased.

Date of sale/transfer u/s 6A	Sr. No. of Bill/ invoice / transfer voucher	Description of goods and quality	Sales price / value of goods transferred	Amount of Central Sales Tax, charged, if any	[Railway Receipt No./ Transport Receipt No. and date under which goods were despatched
(1)	(2)	(3)	(4)	(5)	(6)

Name and address of the carrier	Name, address and Registration No. of the dealer / principal agent giving declaration in Form C / Form F or Government office not being registered issuing certificate in Form D	Serial No. and date of the declaration certificate in Form C/F/D	No. and date of certificate in Forms E-I or E-II against which the goods sold were purchase E-I E-II
(5B)	(6)	(7)	(8)

[FORM IA (B)]

[See rule 4A (2)]

Register of declaration forms maintained (by the purchasing dealer)
under rule 4A (2) of the Central Sales Tax (Bombay) Rules, 1957

RECEIPT

Date of Receipt	Authority from whom received	Book No.	Serial No. From To
(1)	(2)	(3)	(4)

ISSUE

Date of issue	Book No.	Serial No.	(i) Name and address of seller to whom issued. (ii) His local and Central Sales Tax No. and date of effect.	No. and date of order in receipt of which issued
(5)	(6)	(7)	(8)	(9)

Description of goods in respect of which issued	Value of the goods	Seller's cash memo/ challan No. in reference to which issued	No. and date of railway receipts or other carrier's challan for the goods	Surrendered to (sales tax authority)	Remarks
(10)	(11)	(12)	(13)	(14)	(15)

Sr. No.	Form	Meant For
	Form A	Application for 'Registration' as registered dealer.
	Form B	'Registration' Certificate
	Form C	'Declaration' by Registered Dealer
	Form D	Declaration by Government
	Form E- 1	Declaration by dealer who first move goods from one State to another State or first dealer who effects sale in the Inter-State movement of goods.
	Form E-2	Declaration given by first or subsequent transferor on the series of sales in Inter-State sale when first movement occasioned the Inter-State Sale or by second and subsequent transfer or, when the first transfer resulted in Inter-State Sale.
	Form F	Declaration by Principle at the time of sending goods to Agent or Branch.
	Form G	It is an Indemnity Bond at the time when Form 'F', 'C', E-1, E-2 has been lost.
	Form H	Export Certificate.

Check your progress 5

1. The purpose of Form H is _____.
- a. Export certificate
 - b. Indemnity bond
 - c. certificate

2.7 Illustrations

Illustration 1

Mr. Alok Nath had gross turnover of Rs. 5,00,000 for the accounting year 2000-2001. Keeping in view the following facts you are required to calculate his taxable turnover:

Sum of aggregate turnover Percentage of tax Rs.

Rs.	
50,200	@ 5%
56,000	@ NIL (Exempted)
2,07,000	@ 10%
1,86,800	@ 4%
5,00,000	

Solution

Mr. Alok Nath

(Calculation of Taxable Turnover)

Detail	Rs.	Rs.
Gross Turnover	5,00,000	
Less: Exempted Turnover	(-) 56,000	4,44,000
Less: Tax included in Turnover $(i) \frac{50,200 \times 5}{100 + 5}$ or $\frac{50,200 \times 5}{105}$	2,390.50	

$(ii) \frac{2,07,000 \times 10}{100 + 10}$ or $\frac{2,07,000 \times 10}{110}$	18,818.00	
$(iii) \frac{1,86,800 \times 4}{100 + 4}$ or $\frac{1,86,800 \times 4}{104}$	7,184.50	28,393
Taxable Turnover		4,15,607

Illustration 2

You are required to calculate 'Sales Tax' with the help of the following information supplied by Mr.Brijlal.

Sale of undeclared goods to a registered dealer (as such this commodity has not been shown by his registration certificate) and Rate of Tax is by 5%	Rs. 11,00,000
Sale to Government on Form D	Rs. 1,54,000
Sale of declared goods to unregistered dealer (Govt. Rate is 3%).	Rs 3,50,000
Sale of undeclared goods to a registered dealer (as such this commodity, has not been shown by his registration certificate and Rate of Tax is 8% in the state)	Rs.1,80,000
Sale to registered dealer for resale on Form C (such commodity/goods are registered under registration certificate).	Rs. 4,00,000

Solution

Sr. No.	Detail	Rs.
1	Sale of undeclared goods to a registered dealer [5% or 10% whichever is higher (Rs. 11, 00,000 x 10%)]	1,10,000
2	Sale to Government on Form D (@ 4% on Rs. 1,54,000)	6,160
3	Sales of declared goods to unregistered dealer [double the existing rate i.e. 6%](@6% of Rs. ;i,50,000)	21,000
4	Sale of undeclared goods to a registered dealer [8% or 10% whichever is higher (@ 10% of Rs. 1,80,000)	18,000
5	Sale to registered dealer on Form C (@ 4% of Rs. 4,00,000)	16,000
6	Total Tax Payable	1,71,160

Illustration 3

Following information regarding inter-state sales has been disclosed by M/s Chandanand Danny.

You are required to compute CST payable on them.

(i) Sale of Books (Exempted in U.P.)	50,250
(ii) Sale of Tobacco (Exempted in U.P.)	15,05,000
(iii) Sale of Plant on Form D to Government	14,00,000
(iv) Sale of that undeclared goods to registered dealer which is not registered in certificate	11,00,000
(v) Sale of declared goods to unregistered dealer on which U.P. Government is imposing CST @ 4%	7,70,000

(vi) Sale of undeclared goods to registered dealer on which U.P. Government is imposing CST @ 2%	10,15,000
(vii) Sale for resale to registered dealer of registered goods on Form C	12,65,00
viii) Sale to registered dealer of such goods which not registered in the certificate and U.P. Government is imposing 6% CST.	19.01,050

Solution

M/s Chandanand Danny

Calculation of CST Payable

Sr. No.	Detail	Rs.	Rs.
1.	Sale of goods (because exempted)	50,250	NIL
2.	Sale of Tobacco (because exempted)	15,05,000	NIL
3.	Sale of Plant to Government on Form D @ 4%	14,00,000	53,846
	$\left(\frac{\text{Rs. } 14,00,000 \times 4}{104} \right)$		
4.	Sales of undeclared goods to registered dealer which is not registered in certificate @ 10%	11,00,000	1,00,000
	$\left(\frac{\text{Rs. } 11,00,000 \times 4}{110} \right)$		
5.	Sale of declared goods to unregistered dealer (Double to U. P. State's rate i.e 8%)	7,70,000	57,037
	$\left(\frac{\text{Rs. } 7,70,000 \times 8}{108} \right)$		

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6.	Sale of undeclared goods to registered dealer @ 2%	10,15,000	19,902
	$\left(\frac{\text{Rs. } 10,15,000 \times 2}{102} \right)$		
7.	Sale for resale to registered dealer of registered goods on Form 'C' @ 4%	12,65,000	48,654
	$\left(\frac{\text{Rs. } 12,65,000 \times 4}{104} \right)$		
8.	Sale to registered dealer of such goods which are not registered in the certificate (Actual i.e. 6% or 10% whichever is higher)	19,01,000	1,72,818
	$\left(\frac{\text{Rs. } 19,01,000 \times 10}{110} \right)$		
	Total Tax Payable		4,52,257

Illustration 4

During the month of November 2000, Mr.Ebrahim made inter-state sales of Rs. 11, 00,400. The sales are inclusive of sale tax and were made against Form 'C'. You are required to calculate taxable turnover and CST payable assuming that the state sales tax rate for such goods is 8%. What will be your answer if sales is made to a unregistered dealer.

	= Rs. 10,58,077
(ii) CST	= $\frac{\text{Rs. } 11,00,400 \times 4}{100 + 4}$
	= $\frac{\text{Rs. } 11,00,400 \times 4}{104}$
	= Rs. 42,323

(B) (Sales to unregistered dealer):

It includes CST @ 10% because the goods are sold to unregistered dealer.

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Central Sales
Tax Act 1956

Therefore,

$$(i) \text{ Taxable turnover} = \frac{\text{Rs. } 11,00,400 \times 100}{100 + 10}$$

$$= \frac{\text{Rs. } 11,00,400 \times 100}{110}$$

$$= \text{Rs. } 10,00,363$$

$$(ii) \text{ CST} = \frac{\text{Rs. } 11,00,400 \times 10}{100 + 10}$$

$$= \frac{\text{Rs. } 11,00,400 \times 10}{110}$$

$$= \text{Rs. } 1,00,036$$

Illustration 5

From the following details, compute the central sales-tax payable by a dealer carrying on business in New Delhi:

	Rs.
Turnover Total for the year which included	16,00,000
(i) Trade commission for which credit notes have to be issued separately.	48,000
(ii) Installation charges	25,000
(iii) Excise duty	80,000
(iv) Freight, insurance and transport charges recovered separately in the invoices	60,000
(v) Goods returned by dealers within six months of sale, but after the end of financial year	40,000
(vi) Central Sales-tax	
Buyers have issued 'C' forms for all purchases.	

Solution

Determination of aggregate of Sales prices

Detail	Rs.	Rs.
Gross Turnover		16,00,000
Less:		
(i) Trade discount	48,000	
(ii) Installation charges	25,000	
(iii) Excise duty (not deductible)	NIL	
(iv) freight	60,000	
(v) Goods returned	40,000	1,73,000
Aggregate of Sales prices		14,27,000

[CST Rate @ 4%]

$$\begin{aligned} \text{Therefore, CST Payable} &= \left(\frac{\text{Rs. } 14,27,000 \times 4}{104} \right) \\ &= \text{Rs. } 54,881.61 \text{ say Rs. } 54,885 \end{aligned}$$

Illustration 6

Mr. Faza1 is a dealer. His sales during the first quarter of 2000-2001 (April to June) are as under:

	Date	Invoice Nos.	Amount Rs
(i)	05-04-2000	103/FCA/01/2000	10,000 plus tax @ 4%
(ii)	12-04-2000	103/FCA/02/2000	80,000 plus tax @ 4%

(iii)	05-05-2000	103/FCA/03/2000	62,400 (inclusive of tax)
(iv)	06-06-2000	103/FCA/04/2000	14,000 plus C.S.T. @ 4%
(v)	27-06-2000	103/FCA/05/2000	18,000 plus C.S.T. 4%

(vi) Goods worth Rs. 7,000 (exclusive of tax) against Invoice No. 103/FCA/04/2000 were returned on 29-06-2000.

(vii) Goods worth Rs. 13,000 (inclusive of tax) sold on 27-12-1999 were returned on 30-06-2000.

(viii) Goods worth Rs. 6,500 (inclusive of tax) sold on 27-12-1999 were returned on 30-06-2000.

All the above sales were made in the course of inter-state trade. Calculate the turnover and sales tax payable if the rate of tax is 4%.

Solution

Mr.Fazal

Computation of Turnover and Sales Tax

Sr. No.	Detail	Rs.
(i)	Invoice No. 103/FCA/01/2000(Rs. 10,000 + 104%)	10,400
(ii)	Invoice No. 103/FCA/02/2000 (Rs. 80,000 + 104%)	83,200
(iii)	Invoice No. 103/FCA/03/2000	62,400
(iv)	Invoice No. 103/FCA/04/2000 (Rs. 14,000 + 104%)	14,560
(v)	Invoice No. 1031FCA/05/2000 (Rs. 18,000 + 104%)	18,720
	Total	1,89,280

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	Less : Returned goods within 6 months (Rs. 7,000 x 104%)	(-) 7,280
	Aggregate Sales Prices	1,82,000

$$\text{Therefore, CST,} = \left(\frac{\text{Rs. } 1,82,000 \times 4}{104} \right) = \text{Rs. } 7,000$$

$$\text{Therefore, Taxable Turnover} = \left(\frac{\text{Rs. } 1,82,000 \times 100}{104} \right) = \text{Rs. } 1,75,000$$

Illustration 7

A dealer effected following sales during January-March, 2000 quarter

- (i) Invoice No. 65 dated 10th January, 2000 for Rs. 1,76,800.00 (inclusive of tax);
- (ii) Invoice No. 66 dated 21st January, 2000 for Rs. 1,25,000.00 plus tax @ 4%;
- (iii) Invoice No. 67 dated 5th February, 2000 for Rs. 40,000.00 plus C.S.T, @ 4% Rs. 1,600.00;

Goods worth Rs. 10,400.00 (inclusive of taxes) were returned within 6 months.

Calculate the turnover and sales tax payable, if rate of tax is 4%.

Solution

Calculation of Turnover and Central Sales Tax Payable

Determination of Aggregate of Sales Prices

Sr. No.	Detail	Rs.
(i)	Invoice No. 65	1,76,800
(ii)	Invoice No. 66	1,30,000
(iii)	Invoice No. 67	41,600

	Total Sales	3,48,400
	Less: Returned goods within 6 months	(-) 10,400
	Aggregate Sales Price	3,38,000

Rate of CST is 4%,

Therefore,

$$(i) \quad \text{Taxable Turnover} = \left(\frac{\text{Rs. } 3,38,000 \times 100}{104} \right) = \text{Rs. } 3,25,000$$

$$(ii) \quad \text{CST payable} = \left(\frac{\text{Rs. } 3,38,000 \times 4}{104} \right) = \text{Rs. } 13,000$$

Illustration 8

A dealer effected following sales during the first quarter of 2000-2001 (April to June):

- i. Invoice No. 1171 dt.2-4-2000 for Rs. 26,400 plus tax @ 4%.
- ii. Invoice No. 1172 dt.19-4-2000 for Rs. 70,000 plus tax @ 4%.
- iii. Invoice No. 1173 dt.2-5-2000 for Rs. 52,000 (inclusive of tax).
- iv. Invoice No. 1174 dt.4-6-2000 for Rs. 12,200 plus CST @ 4%.
- v. Invoice No. 1175 dt.25-6-2000 for Rs. 20,000 plus CST @ 4%.
- vi. Goods worth Rs. 6,100 (exclusive of tax) against invoice No. 1174 were returned on 28-6-2000.
- vii. Goods worth Rs. 5,200 (inclusive of tax) sold on 25-12-1999 were returned on 30-6-2000.

All the above sale were made in the course of inter-state trade.

Calculate the turnover and sales tax payable if the rate of tax is 4%.

Solution

Computation of Taxable Turnover and CST Payable Determination of Aggregate Sales Prices

Sr. No.	Detail	Rs.
(i)	Invoice No. 1171 (Rs. 26,400 x 104%)	27,456
(ii)	Invoice No. 1172 (Rs. 70,000 x 104%)	72,800
(iii)	Invoice No. 1173	52,000
(iv)	Invoice No. 1174 (Rs. 12,200 x 104%)	12,688
(v)	Invoice No. 1175 (Rs. 20,000 x 104%)	20,800
	Total Sales Price	1,85,744
	Less: Returned goods within 6 months (Rs 6,100 x 104%)	6,344
	Aggregate Sales Price	1,79,400

CST Rate is 4%

(i) Therefore

$$\text{Taxable Turnover} = \left(\frac{\text{Rs. } 1,79,400 \times 100}{104} \right) = \text{Rs. } 1,72,500$$

$$(ii) \quad \text{CST Payable} = \left(\frac{\text{Rs. } 1,79,400 \times 4}{104} \right) = \text{Rs. } 6,900$$

Illustration 9

M/s Gemini Bros., Mumbai are dealing in two products A and B. The gross inter-state sales are Rs. 5 lakh and Rs. 3 lakh respectively during the financial year 2000-2001. No CST was charged in the invoice. If sold within Maharashtra, the rates of sales tax are 6% and 5% on products A and B respectively. Product B is declared goods included under Section 14 of the CST Act. The other details in respect of the financial year 2000-2001 are as follows:

- M/s Johuree Brothers imports product A from Japan, stocks it and then sells it from its godown.

- Product A worth Rs. 1 lakh was returned by a customer in March 2001, as this was in excess of his requirements. The product A had been sold to him in June, 2000.
- Product A worth Rs. 0.5 lakh was imported but was sold by transfer of documents to abuyer in New Delhi before it was cleared from customs. Customs Duty was paid by the buyer from New Delhi.
- The C Form was received in respect of the balance sale of product A.
- Out of the total sale of product B, sales of Rs. 1 lakh were inclusive of packing charges Rs. 5,000, transport charges Rs. 3,000 and transit insurance Rs. 3,500. The charges were shown separately in the invoice. The D Form was received in respect of these sales. These goods were purchased by M/s. JohureeBrothers from a manufacturer in Mumbai for Rs. 75,000 which included Maharashtra Sales tax of Rs. 5,500.

You are required to work out the turnover and the CST liability for the year 2000-2001. Will M/s JohureeBrothers be able to obtain any refund of tax paid on purchases? If so, how much?

Solution

Calculation of Turnover and CST Liability in respect of M/s Gemini Bros., Mumbai

Detail	Aggregate Sale Price Rs.	Sale Tax Rate	Turnover Rs.	CST Payable Rs.
Product A:				
(1) Sale returns of Rs. 1 lakh is after more than 6 months, CST in therefore payable on this sale @ 10% as no form has been received (Even if 'C' form is received it will not be valid).	1,00,000	10%	90,909	9,091
(2) As goods are sold by transfer of document before clearance from custom	50,000	-	50,000	-

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authority no CST liability				
(3) Balance Sale (C form received)	3,50,000	4%	3,36,538	13,462
(X)	5,00,000		4,77,447	22,553
Product B:				
(1) Freight and transit insurance will be deducted. Packing material not deductible (1,00,000 - 6,500)	93,500	4%	89,904	3,596
Balance Sale	2,00,000	4%	1,92,308	7,692
(Y)	2,93,500		2,82,212	11,288
Grand Total (X + Y)	7,93,500		7,59,659	33,841

2.8 Let Us Sum Up

This unit discusses about the The Central Sales-Tax (Registration And Turnover) Rules in much detail. This portion discusses about the various rules under the central sales tax act. These rules may be called the Central Sales-tax (Registration and Turnover) Rules, 1957. These rules are basically the definition clause and discusses the definitions of various terminologies under central sales tax act.

This unit even discusses the registration, amendment procedure of central sales tax registered dealer. The through knowledge of which is considered to be very essential for the students of taxation.

This portion is certainly going to be of great help for the students of this course in attaining this objective.

2.9 Answer for Check Your Progress

Check your progress 1

Answers: (1-a)

Check your progress 2

Answers: (1-b)

Check your progress 3

Answers: (1-a)

Check your progress 4

Answers: (1-b)

Check your progress 5

Answers: (1-a)

2.10 Glossary

1. **Sales Tax** - Tax imposed as a percentage of the price of goods (and sometimes services). The tax is generally paid by the buyer but the seller is responsible for collecting and remitting the tax to the tax authorities
2. **Turnover** - Volume of business of an enterprise as set forth in the profit and loss account. It is usually measured by reference to the gross receipts, or gross amounts due, from the sale of goods or services etc. supplied by the entity.
3. **Turnover Tax** - General term used to refer to the different forms of consumption and sales taxes
4. **Value Added Tax (VAT)** - Specific type of turnover tax levied at each stage in the production and distribution process. Although VAT ultimately bears on individual consumption of goods or services, liability for VAT is on the supplier of goods or services. VAT normally utilises a system of tax credits to place the ultimate and real burden of the tax on the final consumer and to relieve the intermediaries of any final tax cost.

2.11 Assignment

Briefly discuss various forms of declaration under CST Act.

2.12 Activities

Explain the registration procedure involving under the CST Act.

2.13 Case Study

Who is liable for pay CST? Discuss.

2.14 Further Readings

1. The Economics of Taxation, Bernard Salanié, MIT Press, 1997
2. The Economics of Taxation, Henry Aaron and Michael J. Boskan, The Brookings Institution, 1980
3. The Philosophy of Taxation and Public Finance, Robert W. McGee
4. Taxation: Its Principles and Methods, Luigi Cossa

Block Summary

The best efforts have been made to explain the topics in very easy language and in most interesting ways. Sufficient illustrations and pictures have been added to make the content more interesting and easy understandable. The whole block has been divided into two units

Unit one explains the Central sales tax act 1956. Here detailed discussion has been made on Definitions, Person liable to pay CST, Rates of CST, Sales turnover, Exemption from CST, Registration under CST Act. Unit second explains the Rules under central sales tax act 1956. It discusses about Rules under CST act, Certificate of Registration, Amendment or Cancellation of Certificate of Registration, Determination of Turnover Forms for Declaration, Illustrations.

This block will certainly prove it self to be of great importance for the students of this stream in getting this subject in a much better way.

Block Assignment

Short Answer Questions

1. Person liable to pay CST.
2. Liability to tax on Inter-State Sales.
3. Rates of CST.
4. Determination of turnover.
5. Exemption from CST.
6. Forms for declarations.
7. Rules under CST act.
8. Certificate of registration.
9. Amendment or cancellation of certificate of registration.
10. Determination of turnover.
11. Forms for declaration.

Long Answer Questions

1. Explain the sales turnover and exemption from CST.
2. Discuss the process of application of Certificate of Registration under CST?



“

*Education is something
which ought to be
brought within
the reach of every one.*

”

- Dr. B. R. Ambedkar



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TAXATION FOR MANAGERS

PGDF-204

BLOCK 4: HEADS OF INCOME

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TAXATION FOR MANAGERS



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ROLE OF SELF INSTRUCTIONAL MATERIAL IN DISTANCE LEARNING

The need to plan effective instruction is imperative for a successful distance teaching repertoire. This is due to the fact that the instructional designer, the tutor, the author (s) and the student are often separated by distance and may never meet in person. This is an increasingly common scenario in distance education instruction. As much as possible, teaching by distance should stimulate the student's intellectual involvement and contain all the necessary learning instructional activities that are capable of guiding the student through the course objectives. Therefore, the course / self-instructional material are completely equipped with everything that the syllabus prescribes.

To ensure effective instruction, a number of instructional design ideas are used and these help students to acquire knowledge, intellectual skills, motor skills and necessary attitudinal changes. In this respect, students' assessment and course evaluation are incorporated in the text.

The nature of instructional activities used in distance education self-instructional materials depends on the domain of learning that they reinforce in the text, that is, the cognitive, psychomotor and affective. These are further interpreted in the acquisition of knowledge, intellectual skills and motor skills. Students may be encouraged to gain, apply and communicate (orally or in writing) the knowledge acquired. Intellectual-skills objectives may be met by designing instructions that make use of students' prior knowledge and experiences in the discourse as the foundation on which newly acquired knowledge is built.

The provision of exercises in the form of assignments, projects and tutorial feedback is necessary. Instructional activities that teach motor skills need to be graphically demonstrated and the correct practices provided during tutorials. Instructional activities for inculcating change in attitude and behavior should create interest and demonstrate need and benefits gained by adopting the required change. Information on the adoption and procedures for practice of new attitudes may then be introduced.

Teaching and learning at a distance eliminates interactive communication cues, such as pauses, intonation and gestures, associated with the face-to-face method of teaching. This is particularly so with the exclusive use of print media. Instructional activities built into the instructional repertoire provide this missing interaction between the student and the teacher. Therefore, the use of instructional activities to affect better distance teaching is not optional, but mandatory.

Our team of successful writers and authors has tried to reduce this.

Divide and to bring this Self Instructional Material as the best teaching and communication tool. Instructional activities are varied in order to assess the different facets of the domains of learning.

Distance education teaching repertoire involves extensive use of self-instructional materials, be they print or otherwise. These materials are designed to achieve certain pre-determined learning outcomes, namely goals and objectives that are contained in an instructional plan. Since the teaching process is affected over a distance, there is need to ensure that students actively participate in their learning by performing specific tasks that help them to understand the relevant concepts. Therefore, a set of exercises is built into the teaching repertoire in order to link what students and tutors do in the framework of the course outline. These could be in the form of students' assignments, a research project or a science practical exercise. Examples of instructional activities in distance education are too numerous to list. Instructional activities, when used in this context, help to motivate students, guide and measure students' performance (continuous assessment)



PREFACE

We have put in lots of hard work to make this book as user-friendly as possible, but we have not sacrificed quality. Experts were involved in preparing the materials. However, concepts are explained in easy language for you. We have included many tables and examples for easy understanding.

We sincerely hope this book will help you in every way you expect.

All the best for your studies from our team!



TAXATION FOR MANAGERS

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CENTRAL SALES TAX AND RULES UNDER SALES TAX

UNIT 1

CENTRAL SALES TAX ACT 1956

Meaning and Definitions, Person liable to pay CST, Rates of CST, Sales turnover, Exemption from CST, Registration under CST Act

UNIT 2

RULES UNDER CENTRAL SALES TAX ACT 1956

Introduction, Rules under CST act, Certificate of Registration, Amendment or Cancellation of Certificate of Registration, Determination of Turnover Forms for Declaration, Illustrations

BLOCK 4:

SERVICE TAX

UNIT 1

SERVICE TAX 1994

Introduction, Meaning of Service Tax, Objectives of Service Tax Act, 1994, Scope of Service Tax Act, 1994, Taxable Services, Payment of Service Tax

**UNIT 2****RETURNS OF SERVICE TAX**

Furnishing of Return, Person responsible for collecting Service Tax to furnish prescribed return, Procedure for filling of return, Memorandum in Form ST-3A, Late Return, Penalty, Return by Non-Resident, Maintenance of Records, Accounting treatment for Taxable ServiceCategory



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TAXATION FOR MANAGERS

BLOCK 4: SERVICE TAX

UNIT 1

SERVICE TAX 1994

03

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BLOCK 4: SERVICE TAX

Block Introduction

This block covers the topic Service tax. Servicetax is one of the most important indirect tax as it is collected from the client by the service provider and then deposited in the government account by the service provider. The writer has tried his best to explain the topics in very easy language and in most interesting ways. Sufficient illustrations have been added to make the content more interesting and easy understandable. The whole block has been divided into two units.

In this block Unit 1 covers the basics of Service tax 1994. It gives a brief introduction, of the act, meaning of Service Tax, Objectives of Service Tax Act, Scope of Service Tax Act, 1994, Taxable Services, Payment of Service Tax, whereas the Unit 2 covers the Returns of service tax i.e. the various types of returns or forms which have to be submitted to the service tax authorities. These returns have to be filled by the person who is collecting the service tax. This unit covers the process of furnishing of return, person responsible for collecting, prescribed returns to be filled, procedure for filling of return, memorandum in Form ST-3A, late Return, penalty, return by Non-Resident, maintenance of records, accounting treatment for taxable service.

This block is going to be of great help for the students of management who want to opt taxation and finance as their field of career.

Block Objective

After learning this block, you will be able to understand:

- Service tax and exemptions under it.
- The legal provisions Explain.
- Registration procedure under service tax.
- Process of return filling.
- Non resident return filling.

Service
Tax

Block Structure

Unit 1: Service Tax 1994

Unit 2: Returns of Service Tax

UNIT 1: SERVICE TAX 1994

Unit Structure

1.0 Learning Objectives

1.1 Introduction

1.2 Meaning of Service Tax

1.3 Objectives of Service Tax Act, 1994

1.4 Scope of Service Tax Act, 1994

1.5 Taxable Services

1.5.1 Meaning of the Term “Service”

1.5.2 Categories of Services Rendered by a Person

1.5.3 Meaning of “Client”

1.5.4 Taxable Services

1.5.5 Taxable Services Provided to a Client

1.5.6 Exemption from Service Tax

1.6 Payment of Service Tax

1.6.1 Parties held Responsible for Payment of Service Tax

1.6.2 Payment of Service Tax by Non-Resident

1.6.3 Incidence of Service Tax Passed on the Client

1.6.4 Time Limit for Payment of Service Tax

1.6.5 Payment of Service Tax on Receipt Basis

1.6.6 Adjustment for Service Tax Excess Paid

1.6.7 Payment of Service Tax not collected

1.6.8 Procedure for Payment of Tax

1.6.9 Rounding off of Service Tax

1.6.10 Banks Authorised to Collect Service Tax

1.6.11 Provisional Deposit of Tax

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- 1.7 Let Us Sum Up**
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- 1.11 Activities**
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- 1.13 Further Readings**

1.0 Learning Objectives

After learning this unit, you will be able to understand:

- Categorise the services rendered by a person.
- State the taxable services provided to a client.
- Specify exemption from Service Tax.
- Describe valuation of taxable services.
- Name the services rendered to Foreign Clients to India.
- Enumerate the legal provisions under different circumstances for Registration Procedure.
- Explain the procedure for obtaining registration.

1.1 Introduction

In the present dynamic world, it is not possible that we make available the services, without charging any fee or without securing the commercial viability of a service oriented organisation. This is not meant that we generate profits by exploiting the users or prefer profiteering. Indeed, our emphasis here should be on the generation of profits through customer's satisfaction. This change in perception has complicated the act and skill for selling the services.

The term services is not limited to personal services, like auto-servicing, beauty parlor, medical services, legal services, consultancy services etc. On the contrary, it has under connotations according to management gurus. (It is clear that services are activities, benefits or satisfaction given to the individual and the

society in larger perspectives. The services are intangible nature, services can consume during the process of their creation. On the basis of heterogeneity, the services cannot be standardised. It is difficult to judge quality of service. A service has a high degree of perish ability. Flexibility is an important feature of services. These are the main features of services.

Finance Act, 1994, proposed to make provisions for revalidating levy and collection of service tax from users of certain services.

1.2 Meaning of Service Tax

Service tax is an indirect tax levied on certain services provided by specified categories of persons/firms/agencies. The service tax is collected at the consumption stages and at the time of spending the income. As the service tax is mainly levied on the services, it is collected at the time of sale or purchase of the services in the commercial activity of business. The service tax is collected at various stages in the chain of activities of services. The service tax is an important measure for mobilisation of revenue.

Following are the main features of Service Tax.

1. The service tax is convenient in collection and assessment.
2. The service tax has become comparatively more effective in revenue mobilisation.
3. The service tax is difficult to evade as it is generally included in the cost of services sold.
4. The rate of taxes is also different for different services.
5. The revenue from such tax can be increased based on pattern of demand of the services.
6. To begin with, the tax was levied only on three services and was gradually extended to 110 services.
7. Service tax was introduced by the Finance Act, 1994.

Check your progress 1

1. Service tax is a _____.
 - a. Indirect tax
 - b. Direct tax

1.3 Objectives of Service Tax Act, 1994

Service tax in India is a taxation source to achieve the objective of economic growth. The objectives of service tax are mainly as follows:

- To raise revenue and the same time to control expenditure and investment.
- To induce the investment to capital formation.
- To accelerate the growth rate to the maximum extent possible.
- To divert money in desired sectors.
- To restrict the consumption of undesirable expenditure and increase the savings.
- To provide various exemptions and concession taking into consideration the need for economic development of the country and the social goals of the society.
- To help the Government to control the inflationary trends by applying the progressive rate of taxes.
- To cover all the segments of the society under taxation.
- To ensure the contribution of every citizen of the nation to its economical growth and at the same time will yield greater revenue.
- To reflect direct relationship with the change in income.
- To ensure the attainment of equality, in incomes wealth and opportunities

The taxation on services, assume the greater importance in growth and development of the economy. In India, where the socio-economic growth pattern for the development is chosen, service tax plays a significant role in the Government functions. By employing the proper coordinated service tax procedure, the attainment of the planning objectives is achieved.

Check your progress 2

1. To induce the investment to capital formation is one of the objectives of _____.
 - a. indirect tax
 - b. service tax

1.4 Scope of Service Tax Act, 1994

The Constitution of India provides the division of the tax powers between the Central and the States. In accordance with the power conferred by the Constitution, the Service Tax Act, 1994 has been enacted. The present Service Tax Act, 1994 is a comprehensive legislation containing various provisions on every aspect of services. The Central Government through its fiscal policies of budgetary planning tried to make the service-tax more effective by including new incentives and new service tax policies.

The Service Tax Act, 1994 is applicable to whole of India. It brings the charge of Service Tax on certain services (As per the list of taxable services as amended from time to time) arising or accruing in whole of the India. The Service Tax Act levies the tax on 'Services'. The term 'service' used in this act has a much wider connotation as it includes different types of services.

As per Section 66 of the Finance Act, 1994, (hereinafter referred to as the Act) Service tax is chargeable on the value of taxable services, computed as per the Section 67 of the Act.

Section 64 to 96 in Chapter V of the Finance Act, 1994, which came into force on 1-7-1994 read with Service Tax Rules 1994 provide the basic legal and procedural frame-work for the levy and collection of Service Tax. Besides, a number of circulars and Trade Notices has been issued by the various commission rates amplifying the provisions of the law.

Section 93 of the Act empowers the Central Government for exempt generally or subject to such conditions as may be specified, by the notification in the Official Gazette any taxable service from the whole or part of service tax leviable. The Government is also empowered to exempt taxable service of any specified description a special order and under circumstances of exceptional nature.

Check your progress 3

1. The _____ provides the division of the tax powers between the Central and the States.
 - a. Constitution of India
 - b. Government of india
 - c. State government

1.5 Taxable Services

The meaning and various categories of Taxable Services rendered by a person are discussed below.

1.5.1 Meaning of the Term “Service”

The term ‘**Service**’ has not been defined in the relevant provisions of the Finance Act, 1994. Hence, its meaning is to be understood in the context, it is used in common parlance. The word ‘service’ is derived from the word ‘serve’ which implies working as a servant. Service thus implies assistance or benefit afforded to another. In other words, service may be defined also system of labour and material aids used to accomplish some regular work such as provision of telephone, postal, train services etc.

1.5.2 Categories of Services Rendered By a Person

A person can broadly render services in three ways, viz.

1. On the basis of regular employment with employer-employee relationship
2. On retainer ship basis without the bonds of employer and employees on the basis of understanding / contract
3. Attending to assigned tasks on the ad hoc basis on payment in the background of expertise possessed
 - a. The first category, it could be said that when a person occupies a regular post or office amounting to service, it is an employment as distinguished from mere engagement in the course of carrying on some profession or vocation. Obviously, service tax is not to be

imposed on receipts by way of salary or wages for the services rendered on employer-employee relationship.

The second category, relates to the persons who render professional services on the basis of retainer ship payable on monthly, half-yearly, or yearly basis - not on the basis of work done. Such persons are neither employees nor ad hoc contractors. Obviously, the position of a retaineer on retainer ship basis is different from that of an employee. An independent contractor gets his remuneration or fees on an ad hoc case-to-case basis which could not be considered as a vital factor to make a difference between the two categories of advisers/consultants/persons rendering services.

The third category mentioned above, i.e. ad hoc assignees of works is concerned, there could be no doubt that these categories fall within the purview of service tax law in the specified fields in the same manner as services rendered on employer-employee relationship fall outside the ambit of this legislation. Hence, consultants, engineers, architects etc. who render service under such an arrangement will have to comply with the provisions of Service Tax legislation.

1.5.3 Meaning of “Client”

Service tax is payable in respect of services provided to a client. 'Client' means an external person. The word 'Client' has been assigned in the following dictionary meanings:

One for whom professional services are rendered, as by an attorney' (Webster's II New Revised University Dictionary).

“Plebeian under protection of noble, (arch) dependent, hanger-on, employer of lawyer, employer or any professional man, customer”.(Oxford English Dictionary).

“An individual, corporation, trust or estate that employs a professional to advise or to assist it in the professional's line of work, professionals include but are now limited to attorneys, accountants, architects etc.’ (Black's Law Dictionary).

Thus, it can be said that a client's is a person who hires or avails the services of another person on payment of an agreed consideration.

1.5.4 Taxable Services

There is no straight definition of this phrase Sub-section (110) of Section 65 of the Finance Act, 1994 (as amended from time to time) defines this phrase not in an abstract way but in relation to various categories of taxpayers by whom such tax is payable. For example, in the case of a Consulting Engineer, 'Taxable service means any service provided to a client in relation to advice, consultancy or technical assistance in any manner in one or more disciplines of engineering. Likewise, in the case of a Management Consultant, taxable service means services to a client in connection with the management of any organisation in any manner.

A 'Management consultant' has been defined in Section 65 (21) to mean any person who is engaged in providing any service, either directly or indirectly in connection with the management of any organisation in any manner and includes any person who rendered any advice, consultancy or technical assistance, relating to conceptualising, devising, development, modification, rectification or up gradation of any working system of any organisation. The sweep of this definition is, prima facie, very wide. The concept of 'Taxable service' has been defined in a similar way in the context of other services like those of Chartered Accountants, Cost Accountants and Architects etc. also.

The taxable services and date from which service tax has been levied thereon are given in the following table.

Taxable Services at a glance

Sr.	Date of Implementation	Types of Service Taxable	Details of Taxable Services
1.	July 1, 1994	Telephone services	Telephone services (including cellular phone services) provided to a subscriber by the telegraph authority.
2.	July 1, 1994	General Insurance	Services provided by general insurance companies to a policy holder in relation to the fire, marine and miscellaneous insurance.
3.	July 1, 1994	Stock-brokers	Services provided by a stock-broker (but not including a sub-broker) to an

Sr.	Date of Implementation	Types of Service Taxable	Details of Taxable Services
			investor, in connection with sale or purchase of securities listed on a recognised stock exchange (including own trading and arbitrage but excluding jobbing).
4.	Nov., 1, 1996	Pager Service	Pager services provided to a subscriber by the telegraph authority.
5.	Nov. 1, 1996	Advertising Agency	Services of an advertising agency (including an advertising consultancy) provided to a client.
6.	Nov. 1, 1996	Courier Agency	Services to a courier agency, provided to a customer in relation to door-to-door transportation of time sensitive documents, goods or articles (including transporters undertaking door to door transportation of goods or articles, often called Express Cargo Service).
7.	June 15, 1997	Custom House Agent (CHA)	Services of a Custom House Agent (CHA) in relation to the entry or departure of conveyances or the import or export of goods (but excludes service provided by the sub-contracting CHA engaged by the main CHA).
8.	June 15, 1997	Steamer Agent	Services of a steamer agent provided to a shipping line (including an enterprise which operates or manages the business of shipping), relating to a ship's husbandry or dispatch or any administrative work related thereto and the booking, advertising or canvassing

Service
Tax

Sr.	Date of Implementat ion	Types of Service Taxable	Details of Taxable Services
			of cargo, including container feeder services.
9.	July 7, 1997	Consulting Engineer	Services of a consulting engineer (including self employed engineers and engineering firms in relation to advice, consultancy or technical assistance in any manner in one or more disciplines of engineering.
10.	July 7, 1997	Manpower Recruitment Agent	Services of a manpower recruitment agency relating to a recruitment of manpower.
11.	July 1, 1997	Air Travel Agent	Services of an air travel agent provided to a customer relating to the booking of passage for travel by air.
12.	July 1, 1997	Mandap keeper	Services of a mandap keeper, relating to the use of a mandap including the facilities provided in relation thereto and the services, if any, rendered as a caterer (includes banquet halls, invitation halls, marriage halls or hall/rooms taken in hotels for organising any social, official or business functions or holding a dance, drama or music programme or competition) and mandaps located within the premises of any temple, church etc. Note: Any person giving his residential house for marriage or other functions etc. and charging rent for the same shall be liable to service tax.

Sr.	Date of Implementation	Types of Service Taxable	Details of Taxable Services
13.	July 16, 1997	Clearing and Forwarding Agent	Services of a clearing and forwarding agent relating to clearing and forwarding operations and are engaged/appointed by the manufacturer of goods (both excisable and non-excisable), producers and distributors of goods shall also include such agent appointed for agricultural and mineral goods.
14.	July 16, 1997 to Feb. 27, 1998 and w.e.f. 1-4-2000	Renting a cab	Services of renting a cab provided to any person.
15.	Sept. 1, 1997 to July 17, 1998 and w.e.f. 1-4-2000	Tour Operator	Services of a tour operator operating tours in a tourist vehicle (including tourist taxis and tourist buses) covered by a tourist permit under the Motor Vehicles Act, provided to any person including services in a package tour such as providing boarding and lodging arrangements, local sightseeing and guide services, providing for porters, booking or arranging accommodation, reservation for entertainment parks, theatres etc. However, services in respect of tours abroad do not attract service tax.
16.	Oct. 16, 1998	An Architect	Professional services of an architect (including a commercial concern rendering services in the field of architecture) provided to a client. The

Sr.	Date of Implementat ion	Types of Service Taxable	Details of Taxable Services
			work of an architect includes providing appropriate advice keeping in view the requirement of the client at the preliminary stage of initial sketches, specifications and drawing of plans, providing detailed drawings, approval of the drawings from the concerned authorities, supervision at each stage of construction till completion certificate is obtained.
17.	Oct. 16, 1998	An Interior Decorator	Services, by way of advice, consultancy, technical assistance or otherwise, of an interior decorator (including a landscape designer) in relation to planning, design or beautification of spaces, whether man-made or otherwise, provided to a client. However, Act directors of films and others who render services of design etc. for setting up temporary structures/settings for shootings etc. are not liable to service tax, as such interior decoration has no pregnancy and is only of a temporary nature.
18.	Oct. 16, 1998	Management Consultant	Services of a management consultant in connection with the management of any organisation, or services by way of active, consultancy or technical assistance, relating to conceptualising, rectification or upgradation of any working system of any organisation rendered to a client.

Sr.	Date of Implementation	Types of Service Taxable	Details of Taxable Services
19.	Oct. 16, 1998	'Chartered Accountant'	<p>Professional services of a practicing Chartered Accountant (including any concern rendering such services) provided to a client.</p> <p>Note: Service tax will be leviable on services of auditing and accounting, cost accounting / auditing, secretarial auditing, verification, certification and other specified services.</p> <p>Services other than the accounting and auditing and other specified services have been exempted from Service Tax</p>
20.	Oct. 16, 1998	Cost Accountant	<p>Professional services of a practicing cost accountant (including any concern rendering such services), provided to a client</p>
21.	Oct. 16, 1998	Company Secretary	<p>Professional services of a 'practicing company secretary (including any concern rendering such services) provided to a client.</p>
22.	Oct. 16, 1998	A Real Estate Consultant	<p>Services of areal estate agent in relation to sale, purchase, leasing or renting, of real estate or services of areal estate consultant by way of advice consultancy or technical assistance, in relation to evaluation, conception, design, development construction, implementation, supervision, maintenance, marketing acquisition or management of real estate, provided to a client. Besides, services to real estate</p>

Sr.	Date of Implementat ion	Types of Service Taxable	Details of Taxable Services
			<p>developers and promoters in respect of evaluation of a proposed real estate scheme / project by conducting techno-economic studies, providing feasibility reports and by even helping in marketing real estate projects, shall also attract service tax. However, activity of actual construction of any building, carried out by builders/ developers does not attract service tax levy.</p>
23.	Oct. 16, 1998	Security Agency	<p>Services of providing security personnel or otherwise and including services of investigation, detection or verification of any fact or activity, by a security agency in relation to the security of any property or person. Thus, detective agencies providing confidential services in respect of say, financial creditability etc. are also liable to service tax. Note : Services of providing safe deposit lockers or security/safe vaults, either by banks or by others have been exempted</p>
24.	Oct. 16, 1998	'Credit Rating Agency'	<p>Services of a credit rating agency in relation to credit rating of any debt obligation or any project or programme requiring finance, or any financial obligation, instrument or security provided to a client. The taxable services of a credit rating agency include giving the rating for a debt instrument and subsequent surveillance until the entire debt is repaid. However,</p>

Sr.	Date of Implementation	Types of Service Taxable	Details of Taxable Services
			<p>information and advisory services, services of research and information such as analysis of industries in specific sectors, of financial and business outlook of a company, other customised services on say business houses and capital markets, indexing services and information services such as privatisation policy for infrastructure projects, macro studies of infrastructure sector, implication of Government policy in respect of any sector, financial modelling, bid evaluation power purchase agreements etc. would not attract service tax.</p>
25.	Oct. 16, 1998	‘Market Research Agency’	<p>Services of a market research agency in relation to market research or any product service or utility, including all types of customised and syndicated research services provided to a client.</p> <p>Market research includes research based services in respect of consumer markets, industrial marketing, business to business marketing, social and rural marketing, strategic research and brand positioning development, new product development research, creative development research, brand name, logo, pack label research, corporate image, diagnostic market research, customer research etc. and is based on the requirements of the client.</p>

Sr.	Date of Implementation	Types of Service Taxable	Details of Taxable Services
26.	Oct. 16, 1998	‘An Underwriter’	Services of an underwriter in relation to underwriting, provides to a client “Underwriting” has the meaning assigned to it in Clause (g) of rule 2 of the SEBI (underwriter) Rules, 1993.
	Oct. 16, 1998 to Feb. 29, 2000	‘Mechanised Slaughter House’	Services of amechanised slaughter house in relation to the slaughtering of bovine animals. Note: Mechanised slaughter houses have been exempted from service tax w.e.f. 1-3-2000.

1.5.5 Taxable Services Provided to a Client

It may be noted that a taxable service is liable to service tax, only when the service is provided to the ultimate user of that service or the client. When a taxable service is provided by an intermediary, it is not liable to tax. For example, the service of a stock-broker is liable to service tax, but the same service when provided by a sub-broker is not taxable, because he is rendering his service to his main stock-broker through the ultimate benefit of such service ensures to the investor (i.e. client). The stock-broker will, however, include the commission paid to the sub-broker in the bill raised on the investor.

The person who provides the taxable service is liable to pay the service tax. The Central Government may, however, prescribe the person liable to pay the service tax in respect of any taxable service.

Besides, it is a commercial concern rendering a taxable service which is liable to pay service tax. A concern rendering a taxable service on non-commercial basis is not liable to service tax. For example, the Speed Post services provided by the Department of Post do not attract Service Tax.

1.5.6 Exemption from Service Tax

Exemption from the Service Tax, nature of exemption is given in the following table.

Sr. No	Taxable Service	Nature of Exemption
1.	All services	When payment received in convertible foreign exchange.
2.	Telephone	Public telephones for local calls and free telephones at airports and hospitals. Specified Diplomatic Missions and members thereof United Nations/International Organisations.
3.	Insurance	Specified General Insurance Schemes Specified Diplomatic Missions Jan ArogyaBima Policy United Nations/International Organisations. Group Personal Accident Scheme provided by the Government of Rajasthan to its employees.
4.	Advertising Agencies	United Nations /International Organisations Specified Diplomatic Missions
5.	Courier Agencies	United Nations/International Organisations Specified Diplomatic Missions
6.	Security Agency	Charges for providing sale deposit lockers or security or safe vaults, for security of movable property.
7.	Chartered Accountant Cost Accountant Company Secretaries	Services other than of auditing and accounting and other specified services of verification/certification.
8.	Mechanised Slaughter Houses	Service tax in excess of Rs. 100/- per bovine animal Full exemption w.e.f. 1-3-2000

Sr. No	Taxable Service	Nature of Exemption
9.	Overseas Projects	All taxable services rendered in India in respect of overseas projects for which payment is made in convertible foreign exchange
10.	Mandap keeper	When also providing catering services – 40% of the gross amount charged is exempt.
11.	Air Travel Agent	(i) Any amount other than commission, received from the airline is exempt, (ii) United Nations/International Organisations, (iii) Specified Diplomatic Missions
12.	Consulting Engineer	(i) Service in relation to computer software (ii) Charges for a foreign project received in convertible foreign exchange is exempt.
13.	Tour Operator	(i) Providing package tour (i.e. transportation and accommodation for stay of tourists). 60% of the gross amount charged is exempt, (ii) Providing services solely for arranging or booking accommodation for tourists – 90% of the gross amount charged is exempt. (iii) United Nations/International Organisations, (iv) Specified Diplomatic Missions
14.	Rent-a-cab Scheme Operators	Full exemptions w.e.f. 28-2-1999 up to 31-3-2000.

Check your progress 4

1. When a taxable service is provided by an intermediary, it is _____ to tax.

- a. liable
- b. Not liable

1.6 Payment of Service Tax

1.6.1 Parties held Responsible for Payment of Service Tax

From 1-9-1999 the clearing and forwarding agent shall be responsible for payment of service tax in respect of such services. Prior to 1-9-1999; the liability was upon the person engaging such C & F agent.

A taxable service may involve services of an intermediary/sub-agent and when such sub-agent raises a bill on the main agent, service tax shall not be collected by the sub-agent. The word 'Client' is very pertinent and it refers to the person who is the ultimate beneficiary of the service rendered.

It has been clarified that the following persons are not required to pay service-tax.

- Sub-broker
- Directorate of Audio and Visual Publicity (DAVP) in the Ministry of Information and Broadcasting (being not a commercial concern)
- Sub-contracting CHA (Custom House Agent)
- Co-loaders engaged by courier agencies

1.6.2 Payment of Service Tax by Non-Resident

In case of a person who is a non-resident or is from outside India, does not have any office in India and is liable to pay service tax on taxable services provided in India, the service tax shall be paid by such person or any other person authorised by him in this behalf. He shall submit to the Commissioner of Central Excise all whose jurisdiction the taxable services have been rendered, a return separately.

1.6.3 Incidence of Service Tax Passed on to the Client

As per Section 12B of the Central Excise Act, 1944, as extended to service tax matters, every person making payment of service tax shall be presumed to have passed on the incidence of such tax to the client availing the taxable service.

1.6.4 Time limit for Payment of Service Tax

As per rule 6 (1) service tax on the value of taxable services received during a calendar month shall be paid to the credit of the Central Government by the 25th of the next month.

However, in case of individuals, proprietary concerns and partnership firms, service tax on the value of taxable services received during any quarter shall be payable by the 25th of the next month following the quarter”.

1.6.5 Payment of Service Tax on Receipt Basis

Service tax is required to be paid only on the value of taxable service received in a particular month or quarter, as the case may be and not on the gross amount charged or billed to the client.

Thus, service tax will be payable even when the value of taxable service is received in advance.

1.6.6 Adjustment for Service Tax Excess Paid

Where an assessee has paid service tax to the Government treasury, on the basis of advance payment received and subsequently the taxable service is not provided by him either wholly or partly for any reason, the excess service tax so paid by him (calculated on pro rata basis) shall be adjusted against his service tax liability for the subsequent period, provided he has refunded the excess value of taxable service and the service tax thereon.

1.6.7 Payment of Service Tax not collected

A person responsible for collecting the service tax is liable to pay such tax to the credit of the Central Government irrespective of whether he has collected the amount of service tax from the clients or not.

No exemption from payment of service tax can be claimed on the ground that the same was not paid by the client.

1.6.8 Procedure for Payment of Tax

As given in Annexure III, the service tax shall be deposited in yellow colour challenge. Form GAR- 7 into any of the designated banks, under major For minor head codes, serial codes etc. in relation to various taxable services, please refer to the trade notices issued by various Commission rates.

1.6.9 Rounding Off of Service Tax

As per Section 37 D of the Central Excise Act as extended to service tax matters, the amount of service tax shall be rounded off to the nearest rupee, that is, 50 paise or more shall be rounded off to one rupee and less than 50 paise shall be ignored.

1.6.10 Banks Authorised to Collect Service Tax

Service tax shall be deposited in any of the designated banks the assesses shall choose only one branch of the designated bank branches, convenient to him and all payments shall be made in that branch only.

1.6.11 Provisional Deposit of Tax

(Actual Amount Payable Not Ascertainable)

Where an assesses is, for any reason, unable to correctly estimate on the date of deposit the actual amount of service tax payable for any month/quarter, the assesses may make a written request to the Central Excise Officer to make a provisional assessment of the tax on the basis of the amount deposited.

The Central Excise Officer may, on receipt of such request, order provisional assessment of tax and in such cases, the provisions of Rule 9B of the Central Excise Rules, 1944 (except the requirement of execution of bond), shall apply to such assessment.

The assesses shall furnish a statement of difference between the service tax deposited and the service tax liable to be paid for each month in Form ST-3A along with the return. (As in Annexure V while furnishing Form ST-3A following care should be taken.

- This statement is required to be furnished for each month when there is a difference between the amount of service tax payable and the amount actually deposited.
- The statement should be furnished along with the half yearly return.

1.6.12 Interest on Delayed Payment

As per Section 75 of the Act any person fails to deposit the service tax or any part thereof in the account of the Central Government within the specified period, he shall be liable pay simple interest. Present Rate 13% every month or part thereof) alike delay.

The interest has to be computed till the date of final payment of shortfall by the assessee.

1.6.13 Penalty

Fail to file service tax return with in time allowed than Payment of service tax penalty entails penalty, i.e. Rs. 500/- if return is filed within 15 days delay, 1000/- if return filed within 30days delay and Rs. 100 for each day of default (subject to maximum Rs. 2000).

Check your progress 5

1. Fail to file service tax return with in time allowed than Payment of service tax penalty entails penalty, i.e. _____if return is filed within 15 days.
 - a. Rs. 500/-
 - b. Rs. 1000/-
 - c. Rs.1500/-

1.7 Let Us Sum Up

In this unit we have discussed in detail about service tax . We have studied that the term services is not limited to personal services, like auto-servicing, beauty parlor, medical services, legal services, consultancy services etc. On the contrary, it has under connotations according to management gurus. (It is clear that services are activities, benefits or satisfaction given to the individual and the society in larger perspectives. The services are intangible nature, services can consume during the process of their creation. On the basis of heterogeneity, the services cannot be standardised. It is difficult to judge quality of service. A service has a high degree of perishability. Flexibility is an important feature of services. These are the main features of services.

Many other provisions were discussed under service tax have been discussed in very detail and this is going to be of great importance for the students of taxation and finance stream as today almost in every field where services are rendered service tax is imposed . So this is a great opportunity for those students who are going to opt this as their area of expertise.

1.8 Answer for Check Your Progress

Check your progress 1

Answers: (1-a)

Check your progress 2

Answers: (1-b)

Check your progress 3

Answers: (1-a)

Check your progress 4

Answers: (1-b)

Check your progress 5

Answers: (1-a)

1.9 Glossary

1. **Turnover Tax** - General term used to refer to the different forms of consumption and sales taxes.
2. **Underlying Tax** - Tax which is charged on corporate income out of which dividends are paid, but which does not appear as a direct deduction or withholding from the dividend itself.
3. **Trade** - A business, profession, or occupation. A trade often implies a skilled handicraft, which is pursued on a continuing basis, such as carpentry.
4. **Trade Intangible** - A commercial intangible other than a marketing intangible.
5. **Taxpayer Identification Number** - In some countries taxpayers are given an identification number which must be used when filing a tax return and assessing taxes and for all other correspondence between the taxpayer and the tax authorities.
6. **Tax Secrecy** - Obligation usually imposed on tax officials not to reveal particulars about the identity and personal circumstances of taxpayers, or about any of the various aspects governing their tax liability, except in certain strictly limited circumstances.

1.10 Assignment

What do you mean by “Service Tax Act”? Explain the different objects of Service Tax Act, 1994.

1.11 Activities

Explain objects and scope of Service Tax Act, 1994.

1.12 Case Study

Under Service Tax Act, 1994, which services are fully exempted from service tax? Give the list.

1.13 Further Readings

1. The Economics of Taxation, Bernard Salanié, MIT Press, 1997.
2. The Economics of Taxation, Henry Aaron and Michael J. Boskan, the Brookings Institution, 1980.
3. The Philosophy of Taxation and Public Finance, Robert W. McGee.
4. Student Guide to Income Tax, VinodSinghania.
5. Taxation: Its Principles and Methods, Luigi Cossa.

UNIT 2: RETURNS OF SERVICE TAX

Unit Structure

2.0 Learning Objectives

2.1 Introduction

2.2 Furnishing of Return

2.3 Person Responsible for Collecting Service Tax to Furnish Prescribed Return

2.4 Procedure for Filling of Return

2.5 Memorandum in Form ST-3A

2.6 Late Return

2.7 Penalty

2.8 Return by Non-Resident

2.9 Maintenance of Records

2.10 Accounting Treatment for Taxable Service

2.10.1 Books of Accounts

2.10.2 Service Tax to be Disclosed Separately in the Bills

2.10.3 Accounting Entries to be Passed for Service Tax

2.11 Let Us Sum Up

2.12 Answer for Check Your Progress

2.13 Glossary

2.14 Assignment

2.15 Activities

2.16 Case Study

2.17 Further Readings

2.3 Person Responsible for Collecting Service Tax to Furnish Prescribed Return

Every person responsible for collecting the service tax shall furnish or cause to be furnished to the Central Excise Officer in the prescribed form and verified in the prescribed manner, a quarterly return, within fifteen days of the end of the preceding quarter, showing the amount of service tax collected along with necessary information

Check your progress 2

1. Every person responsible for collecting the service tax shall furnish or cause to be furnished to the _____ in the prescribed form.
 - a. Central government
 - b. Central Excise Officer
 - c. State government

2.4 Procedure for Filing of Return

The return is to be filed within 25 days of the end of the each half year. Thus, the due dates for filing of the returns shall be as under:

Half – year	Due Date
April to September	25th October
October to March	25th April

Return Form

While furnishing return of service tax, following care should be taken:

The return shall be accompanied by

- A copy of the quarterly/monthly tax payment challans (Form GAR-7).
- A memorandum of provisional deposit (Form ST-3 A). 3

The return should be furnished within 25 days from the end of the each half-year.

The assessment shall be made on the basis of return and memorandum, if any, by the Superintendent of Central Excise and the triplicate copy of the return so assessed shall be sent to the assessee.

Check your progress 3

1. The return is to be filed within 25 days of the end of the each _____.
 - a. Half yearly
 - b. Quarterly
 - c. yearly

2.5 Memorandum in Form ST-3A

Where there is a difference between the service tax deposited (on provisional basis) and the service tax actually payable for a month, a statement of details of difference and the reasons there for, shall be submitted in Form ST-3A. The statement shall be furnished along with the respective half-yearly return.

Check your progress 4

1. Where there is a difference between the service tax deposited (on provisional basis) and the service tax actually payable for a month, a statement of details of difference and the reasons there for, shall be submitted in _____.
 - a. Form 3A
 - b. Form ST-3A
 - c. Form 2A

2.6 Late Return

Prior to 16-10-1998, a person could furnish a return even after the due date but before the assessment was made. Besides, an assessee could also furnish a revised return, where any error, omission or wrong statement was noticed in a return subsequently, at any time before formalisation of the assessment.

However, w.e.f. 16-10-1998, there is no provision for filing a late/revised return in the service tax law.

Check your progress 5

1. W.e.f. 16-10-1998, there is _____ for filing a late/revised return in the service tax law.
 - a. no provision
 - b. valid provision

2.7 Penalty

Any person who fails to furnish a return by the due date, shall be liable to a penalty of minimum Rs. 100 and maximum Rs. 200, for every week or part thereof, during which the default continues, [Sec. 77].

It has been held that Section 77 lays down minimum penalty of loyal maximum penalty of Rs. 200 for every week's delay.

Check your progress 6

1. It has been held that Section 77 lays down minimum penalty of loyal maximum penalty of _____ for every week's delay.
 - a. Rs. 500
 - b. Rs. 200
 - c. Rs. 1000

2.8 Return by Non-Resident

A person who is a non-resident or is from outside India, does not have any office in India and is liable to pay service tax on taxable services provided in India, such person (or another person authorised by him) is required to pay the tax by means of a demand draft along with a return containing prescribed particulars and other documents.

Check your progress 7

1. A person who is a non-resident or is from outside India, does not have any office in India and is _____ to pay service tax on taxable services provided in India.
 - a. Liable
 - b. Not liable

2.9 Maintenance of Records

No special records have been prescribed for the purpose of service tax. As per Rule 5, the records including computerised data (as maintained by an assessee in accordance with the various laws in force from time to time shall be acceptable.)

The assessee shall furnish to the Central Excise Officer, along with his first return, a list of all accounts maintained by him in relation to service tax including memoranda received from his branch offices for consolidation of service tax figures.

Check your progress 8

1. _____ special records have been prescribed for the purpose of service tax.
 - a. many
 - b. No

2.10 Accounting Treatment for Taxable Service

2.10.1 Books of Accounts

Though no accounts have been prescribed for the purpose of service tax, the assessee should maintain regular and proper accounts, documents and other evidence, such as bill book, ledger, vouchers etc., as may be necessary for assessment of service tax. The accounts should be so maintained that the value of taxable service, service tax liability etc. are correctly ascertainable there from and

the Central Excise Officer does not get an opportunity to resort to best judgment assessment.

2.10.2 Service Tax to be Disclosed Separately in the Bills

Section 12 A of the Central Excise Act, 1944 has been extended to service tax matters also. Thus, all persons liable to pay service tax, should prominently indicate in all the documents relating to assessment, bills etc. the amount of service tax forming part of the total service charges recoverable from the client.

Service tax collected/charged from the client should be shown separately in the contract note or bill. Under the service enactment, tax is payable on receipt of consideration for services rendered. Therefore, it is advisable that in addition to the bill issued for services, the receipt issued for the consideration received should also indicate the amount of service tax payable in respect of the amount received. Thus, even if the client has paid a lump sum amount, in a money receipt amount of service tax be shown separately by doing back calculation. For example, if a bill is raised for Rs. 10,000 towards fees and Rs. 1,000 towards service tax (Total Rs. 11,000). Against the bill, if client makes part payment of Rs. 10,000 only, then in money receipt consideration for services should be shown at Rs. 9,524 and service tax at Rs. 476 (i.e. five per cent of Rs. 9,524). This calculation can be done by applying the following formula:

$$\text{Amount of Service Tax} = \frac{\text{Gross receipt} \times \text{Rate of tax}}{100 + \text{Rate of tax}}$$

Rate of tax is 10.3 % per cent.

Besides, a separate account should be maintained in the ledger for the purpose, crediting with the amount of service tax collected in each bill.

2.10.3 Accounting Entries to be Passed for Service Tax

The accounting entries to be passed on raising a bill for a taxable service and charging service tax thereon shall be as follows:

(1) When the bill is raised on the client		
Client A/c	...Dr	(Total Bill Amount)
To Taxable Service A/c (saybrokerage, etc.)		(Value of Taxable Service)
To Service Tax A/c		(Service Tax charged in the bill)
(2) When the bill is realised		
Bank/ Cash A/c	... Dr	(With Total Bill Amount)
To Client's A/c		
(3) When service tax is deposited in the Government treasury		
Service Tax A/c	... Dr	(With the amount deposited into the
To Bank A/c		Government treasury)

Ultimately "Service Tax Account" should be nullifying. (Closed)

Annexure - Iv

[FORM ST-3]

Return of Service Tax credited to the Government of India

for the period to Collectorate

1. Name of the assessee :
2. Whether an individual or proprietary firm
or partnership firm or any other (please specify) :
3. Category of Service :
4. Service tax registration No. :

Month (s)	Value of taxable service charged or billed (indicate	Value of taxable service realised (indicate break up	Amount of service tax payable	Amount of service tax adjusted in terms of sub-rule (3) of rule 6 of	Amount of interest, if any payable
-----------	--	--	-------------------------------	--	------------------------------------

Service
Tax

	break up of the amount month- wise)	of the amount month- wise	e	the Service Tax Rules, 1994	
1	2	3	4	5	6
Amount paid			Total amount paid [7 (a) + 7 (b) + 7 (c)]		Challan No. and date; Journal Slip No. and date
Service tax paid to the Government credit	Interest paid	Any other amount paid**			
7 (a)	7 (b)	7 (c)	8		
* Please specify and enclose documentary evidence			** Please specify on what account the amount has been paid		

We declare that the above particulars are in accordance with the records and books maintained by us and the correctly stated.

Place:

Signature of Assessee or

Date:

his authorised representative

Assessment Memorandum

1. The Service Tax has been paid correctly.
2. The service Tax has been short/excess paid to the extent of Rs.....

The correct assessment of the Service Tax is as per the following details.

The assessee is requested to pay the deficiency of Rs...Within 10 days form the receipt of this Assessment Memorandum? The assessee may apply for refund, if any, in.....

Date: Signature and Stamp of Central Excise Officer

Returns of
Service Tax

Annexure -V

[FORM ST-3A*]

Memorandum for Provisional Deposit under Rule 6 of the Service Tax (Rules), 1994

For the month of 19.....

Sr. No.	Provisional Value of Taxable Service in terms of Sec. 67 of Act.	Provisional Amount of Service Tax @ 5% paid	Form TR-6 No. and Date.
1	2	3	4

Actual Value of taxable service in terms of Sec. 67	Actual amount of Service tax payable	Difference between the amount of provisionally paid tax and the amount of service tax payable	Form TR-6 No. and date of indication of payment under col. (7)	Remarks
5	5	7	8	9

Reasons for making provisional deposit of service tax.....

Month (s)	Value of taxable service charged or billed (indicate break-up of the amount month-wise)	Value of taxable service realised (indicate break-up of the amount month-wise)	Amount of service tax payable	Amount of service tax adjusted in terms of sub-rule (3) of rule 6 of the Service Tax Rules, 1994	Amount of interest, if any payable
1	2	3	4	5	6
Amount paid			Total amount paid { 7 (a) + 7 (b) + 7 (c) }		Challan No. and date; Journal Slip No. and date
Service tax paid to the Government credit	Interest paid	Any other amount paid**			
7 (a)	7 (b)	7 (c)	8		
* Please specify and enclose documentary evidence			** Please specify on what account the amount has been paid		

Check your progress 9

1. Though no accounts have been prescribed for the purpose of service tax, the assessee_____maintain regular and proper accounts, documents and other evidence.
 - a. should
 - b. should not

2.11 Let Us Sum Up

This portion has discussed in very detail about the furnishing of return under service tax. The unit discusses about assessment memorandum which is completed by the assessing authority after making computation of tax payable and a copy of the return so assessed is sent to the assessed which is treated as an assessment order. It even talks about section 12 A of the Central Excise Act, 1944 has been extended to service tax matters also. Thus, all persons liable to pay service tax, should prominently indicate in all the documents relating to assessment, bills etc. the amount of service tax forming part of the total service charges recoverable from the client. The later portion includes the general offences by companies and firms etc. As per the provisions of Section 81 of the Act, where an offence has been committed by a company, the company as- well as every person who at the time the offence was committed, was in charge of and responsible for the conduct of the business of the company, shall be liable to penalty.

This unit is of great help for the students of taxation and finance stream who are going to be the future tax gurus. They poriton is certainly going to lay the foundation of this act in their mind.

2.12 Answer for Check Your Progress

Check your progress 1

Answers: (1-a)

Check your progress 2

Answers: (1-b)

Check your progress 3

Answers: (1-a)

Check your progress 4

Answers: (1-b)

Check your progress 5

Answers: (1-a)

Check your progress 6

Answers: (1-b)

Check your progress 7

Answers: (1-a)

Check your progress 8

Answers: (1-b)

Check your progress 9

Answers: (1-a)

2.13 Glossary

1. **Taxable Period** - Taxes are levied by reference to a period of time called the "taxable period". Tax year
2. **Taxable Year** - The period (usually 12 months) during which the tax liability of an individual or entity is calculated.
3. **Tax Authorities** - The body responsible for administering the tax laws of a particular country or regional or local authority.

4. **Tax Form** - It is usual to design special forms for taxpayers to declare their taxable income, sales etc. for tax purposes. Forms are designed to facilitate the task of the tax authorities in assessing and collecting tax and will usually draw the taxpayer's attention to any relief he may claim etc. as well as to his statutory duty to make accurate declarations and the penalties that may be imposed if his declaration is incomplete or false

2.14 Assignment

Explain the legal provisions under different circumstances for registration procedure of service tax.

2.15 Activities

Give various steps followed in registration of service tax.

2.16 Case Study

Give the complete procedure followed while furnishing the return of service tax.

2.17 Further Readings

1. The Economics of Taxation, Bernard Salanié, MIT Press, 1997.
2. The Economics of Taxation, Henry Aaron and Michael J. Boskan, the Brookings Institution, 1980.
3. The Philosophy of Taxation and Public Finance, Robert W. McGee.
4. Student Guide to Income Tax, Vinod Singhania.
5. Taxation: Its Principles and Methods, Luigi Cossa.

Block Summary

After going through this block the students would have got a detailed insight of the subject service tax.

The whole of this block was divided into two units. The first unit covers the basics of Service tax 1994 it gives abrief introduction, of the act, the unit discusses briefly about meaning of Service Tax, Objectives and scope of service tax act, what are the taxable services, Payment of Service Tax. Whereas the second unit covers the Returns of service tax i.e. the various types of returns or forms which have to be submitted to the service tax authorities. These returns have to be filled by the person who is collecting the service tax. This unit covers the process of furnishing of return, person responsible for collecting, prescribed returns to be filled, procedure for filling of return, memorandum in Form ST-3A, late Return, penalty, return by Non-Resident, maintenance of records, accounting treatment for taxable service

So after studying this block the students will be feeling confident enough with the subject as sufficent illustrations along with detiled discussion has been given in the block.

Block Assignment

Short Answer Questions

1. Valuation of taxable service.
2. Rate of Service Tax act, 1994.
3. Object of Service Tax Act.
4. Scope of Service Tax Act.
5. Taxable Services.
6. Service tax disclosed in the bills.
7. Accounting entries for service tax.
8. Return of service tax.
9. Payment of service tax.
10. Form TR-6.

Long Answer Questions

1. What do you mean by Service Tax? State the features of Service Tax Act.
2. Define the term 'Service' under Service Tax Act, 1994 and give the list of taxable services under this Act.
3. Explain Form ST-1 (application of registration) along with illustration.
4. Which parties are held responsible for payment of Service Tax?

Enrolment No.

1. How many hours did you need for studying the units?

Unit No	1	2	3	4
No. of Hrs				

2. Please give your reactions to the following items based on your reading of the block:

Items	Excellent	Very Good	Good	Poor	Give specific example if any
Presentation Quality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____ _____
Language and Style	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____ _____
Illustration used (Diagram, tables etc)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____ _____
Conceptual Clarity	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____ _____
Check your progress Quest	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____ _____
Feed back to CYP Question	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	_____ _____

3. Any Other Comments

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*Education is something
which ought to be
brought within
the reach of every one.*

”

- Dr. B. R. Ambedkar



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