STUDY NOTE - 1

OVERVIEW CENTRAL EXCISE

This Study Note includes

- Background
- Classification of Goods
- Valuation of Goods
- Duty on ad-valorem basis
- Other Important Provisions
- Procedures in Central Excise
- Demands,Penalties and Appeals
- Important Provisions of Central Excise Act,1944
- Important Provisions of Central Excise Rules,2002
- Important Rules of Central Excise Valuation Rules,2000
- Rules of Classification

The study notes of final examination of ICWA have been prepared on the basis that basics of the subject have already been studied by students in their intermediate examinations. Hence, initially, overview of each topic is given and then some critical issues are discussed.

1.1 BACKGROUND

Central Excise is a duty on excisable goods manufactured or produced in India, other than alcoholic liquor. Duty liability is principally on 'manufacturer', except in a few cases. In majority of cases, duty rate w.e.f. 1-3-2008 is 14% plus education cess of 2% and Secondary and Higher Education Cess of 1%. Thus, generally, duty is 14.42% (The general duty was 16.48% upto 29-2-2008). There are some exclusions, partial or full exemptions and higher duties in some cases.

Constitutional Background - The duty is levied under powers conferred vide entry 84 and 97 of List I in the Seventh Schedule to Constitution. (Called 'Union List'). The entries read as follows -

Entry No. 84 - Duties of excise on tobacco and other goods manufactured or produced in India except alcoholic liquors for human consumption, opium, narcotic drugs, but including medicinal and toilet preparations containing alcoholic liquor, opium or narcotics.

Entry No. 97 - Any other matter not included in List II, List III and any tax not mentioned in list II or list III. *(These are called 'Residual Powers'.)*

Conditions for levy of excise duty - Basic excise duty is levied under section 3 of Central Excise Act at rates specified in First Schedule and Second Schedule to Central Excise Tariff Act, 1985 (Other duties and cesses are levied under different provisions of law). Section 3 of Central Excise (which is the 'charging section') clearly signifies that there are four basic conditions for levy of Central Excise duty.

(1) The duty is on goods.

(2) The goods must be excisable.

(3) The goods must be manufactured or produced

(4) Such manufacture or production must be in India.

Unless all of these conditions are satisfied, Central Excise Duty cannot be levied.

Ownership of raw material is not relevant for duty liability - Ownership of raw material is not relevant for duty liability – *Hindustan General Industries* v. *CCE* 2003 (155) ELT 65 (CEGAT) * *CCE* v. *Mahindra & Mahindra* 2001(132) ELT 632 (CEGAT).

1.1.1 Duties Leviable

- **Basic Excise Duty u/s 3 of Central Excise Act, which is 14% in vast majority of the cases w.e.f. 1-3-2008 [Till 29-2-2008, it was 16%].**
- Education Cess @ 2% of excise duty under section 93 of Finance (No. 2) Act (w.e.f. 9-7-2004).
- Secondary and Higher Education Cess (SAH Education Cess) @ 1% of the total duties of excise vide section 136 read with section 138 of Finance Act, 2007 w.e.f. 1-3-2007.

Thus, total excise duty is 14.42% in majority of the cases.

National Calamity Contingent Duty – A 'National Calamity Contingent Duty' (NCCD) has been imposed vide section 136 of Finance Act, 2001 on some products. NCCD of 1% has been imposed on mobile phones w.e.f. 1-3-2008.

In addition, cesses and duties have been imposed on some specified products.

1.1.2 Excisable Goods

- As per judicial interpretation, for purpose of levy of Excise duty, an article must satisfy two requirements to be 'goods' i.e. (*a*) it must be movable *and* (*b*) it must be marketable. However, actual sale is not necessary.
- Marketability is to be decided on the basis of condition in which goods are manufactured or produced.
- Everything that is sold is not necessarily 'marketable'.
- Waste and Scrap can be 'goods' but dutiable only if 'manufactured' and are mentioned in Tariff.
- The marketability test requires that the goods *as such* should be in a position to be taken to market and sold. If they have to be separated, the test is not satisfied. Thus, if machinery

has to be dismantled before removal, it will not be goods - *Triveni Engineering* v. *CCE* AIR 2000 SC 2896 = 2000 AIR SCW 3144 = 40 RLT 1 = 120 ELT 273 (SC).

- Branded Software is goods. However, service tax will be payable on tailor made software after Finance Bill, 2008 is passed.

- Section 2(*d*) of Central Excise Act defines Excisable Goods as 'Goods specified in the Schedule to Central Excise Tariff Act, 1985 as being subject to a duty of excise and includes salt. As per explanation to section 2(d), 'goods' includes any article, material or substance which is capable of being bought and sold for a consideration and such goods shall be deemed to be marketable'. Thus, unless the item is specified in the Central Excise Tariff Act as subject to duty, no duty is leviable.

1.1.3 Manufacture

- Taxable event for central excise duty is manufacture or production in India.

- The word 'produced' is broader than 'manufacture' and covers articles produced naturally, live products, waste, scrap etc.

- 'Manufacture' means : (a) Manufacture as specified in various Court decisions i.e. new and identifiable product having a *distinctive name, character or use* must emerge *or* (b) Deemed Manufacture.

- Deemed manufacture is of two types – (a) CETA specifies some processes as 'amounting to manufacture'. If any of these processes are carried out, goods will be said to be manufactured, even if as per Court decisions, the process may not amount to 'manufacture' [section 2(f)(ii)] (b) In respect of goods specified in Third Schedule to Central Excise Act, repacking, re-labelling, putting or altering retail sale price etc. will be 'manufacture'. The goods included in Third Schedule of Central Excise Act are same as those on which excise duty is payable u/s 4A on basis of MRP printed on the package. [section 2(f)(iii) w.e.f. 14-5-2003]

- In *Union of India* v. *Delhi Cloth Mills Co. Ltd.* AIR 1963 SC 791 = 1963 Suppl (1) SCR 586 = 1977 (1) ELT (J199) (SC) and 1990 (27) ECR 151 (SC five member constitution bench) it has been held that the manufacture means bringing into existence a new substance. Thus, manufacture implies a change but every change is not manufacture. A new and different article must emerge having a *distinctive name, character or use.*

1.1.4 Manufacturer

- Manufacturer is the person who actually brings new and identifiable product into existence.

- Duty liability is on manufacturer in most of the cases.

- Mere supplier of raw material or brand name owner is not 'manufacturer'.

- Loan licensee is not 'manufacturer'. Loan licensee can be treated as manufacturer only if the manufacture is carried out by use of his own raw material under his own supervision by hiring the premises and equipment shift-wise or otherwise.

1.2 CLASSIFICATION OF GOODS

The rate of duty is found out by classifying the product in its appropriate heading under Central Excise Tariff. The Central Excise Tariff Act, 1985 (CETA) classifies all the goods under 96 chapters and specific code is assigned to each item. CETA is based on International convention of Harmonised System of Nomenclature (HSN), which is developed by World Customs Organisation (WCO) (That time called as Customs Cooperation Council). This is an International Nomenclature standard adopted by most of the Countries to ensure uniformity in classification in International Trade. HSN is a multi purpose 6 digit nomenclature classifying goods in various groups.

Central Excise Tariff is divided in 20 broad sections. Section Notes are given at the beginning of each Section, which govern entries in that Section. Each of the sections is divided into various Chapters and each Chapter contains goods of one class. Chapter Notes are given at the beginning of each Chapter, which govern entries in that Chapter. There are 96 chapters in Central Excise Tariff. Each chapter and sub-chapter is further divided into various headings and sub-headings depending on different types of goods belonging to same class of products.

All goods are classified using 4 digit system. These are called 'headings'. Further 2 digits are added for sub-classification, which are termed as 'sub-headings'. Further 2 digits are added for sub-sub-classification, which is termed as 'tariff item'. Rate of duty is indicated against each 'tariff item' and not against heading or sub-heading.

Rules for Interpretation of Schedule to Tariff are given in the Tariff itself. These are termed as 'General Interpretative Rules' (GIR). GIR (General Interpretative Rules) are to be applied for interpretation of Tariff, if classification is not possible on the basis of tariff entry and relevant chapter notes and section notes. Following are the steps of classification of a product.

(1) Refer the heading and sub-heading. Read corresponding Section Notes and Chapter Notes. If there is no ambiguity or confusion, the classification is final (Rule 1 of GIR). You do not have to look to classification rules or trade practice or dictionary meaning. If classification is not possible, then only to GIR. The rules are to be applied sequentially.

(2) If meaning of word is not clear, refer to trade practice. If trade understanding of a product cannot be established, find technical or dictionary meaning of the term used in the tariff. You may also refer to BIS or other standards, but *trade parlance* is most important.

(3) If goods are incomplete or un-finished, but classification of finished product is known, find if the un-finished item has *essential characteristics* of finished goods. If so, classify in same heading - Rule 2(a).

(4) If ambiguity persists, find out which heading is specific and which heading is more general. Prefer specific heading.- Rule 3(a).

(5) If problem is not resolved by Rule 3(a), find which material or component is giving '*essential character*' to the goods in question - Rule 3(b).

(6) If both are equally specific, find which comes last in the Tariff and take it - Rule 3(c).

(7) If you are unable to find any entry which matches the goods in question, find goods which are most akin - Rule 4.

(8) Packing material is to be classified in the heading in which the goods packed are classified – Rule 5.

(9) In case of mixtures or sets too, the procedure is more or less same, except that each ingredient of the mixture or set has to be seen in above sequence. As per rule 2(b), any reference to a material or substance includes a reference to mixtures or combinations of that material or substance with other material or substance.

1.3 VALUATION OF GOODS

Excise duty is payable on *one of the following basis* :

- Specific duty, based on some measure like weight, volume, length etc.
- Duty as % of Tariff Value fixed under section 3(2)
- Duty based on basis of Maximum Retail Price printed on carton after allowing deductions - section 4A of CEA.
- Compounded Levy Scheme.
- Duty as % based on *Assessable Value* fixed under section 4 (*ad valorem duty*) (If not covered in any of above)

Specific Duty - It is the duty payable on the basis of certain unit like weight, length, volume, thickness etc. For example, duty on Cigarette is payable on the basis of length of the Cigarette, duty on sugar is based on per Kg basis etc.

Tariff value - In some cases, tariff value is fixed by Government from time to time. This is a "*Notional Value*" for purpose of calculating the duty payable. Once 'tariff value' for a commodity is fixed, duty is payable as percentage of this 'tariff value' and not the Assessable Value fixed u/s 4.

Compounded Levy Scheme - Normal excise procedures and controls are not practicable when there are numerous small manufacturers. Rule 15 of Central Excise Rules provides that Central Government may, by notification, specify the goods in respect of which an assessee shall have option to pay duty of excise on the basis of specified factors relevant to production of such goods and at specified rates. The scheme is presently applicable only to stainless steel pattas/pattis and Aluminium circles. These articles are not eligible for SSI exemption.

1.3.1 Value based on Retail Sale Price

Section 4A of CEA empowers Central Government to specify goods on which duty will be payable based on 'retail sale price'.

The provisions for valuation on MRP basis are as follows -

(a) The goods should be covered under provisions of Standards of Weights and Measures Act or Rules [section 4A(1)].

(b) Central Government has to issue a notification in Official Gazette specifying the commodities to which the provision is applicable and the abatements permissible. Central Government can permit reasonable abatement (deductions) from the 'retail sale price' [section 4A(2)].

(c) While allowing such abatement, Central Government shall take into account excise duty, sales tax and other taxes payable on the goods [section 4A(3)].

(d) The 'retail sale price' should be the maximum price at which excisable goods in packaged forms are sold to ultimate consumer. It includes all taxes, freight, transport charges, commission payable to dealers and all charges towards advertisement, delivery, packing, forwarding charges etc. If under certain law, MRP is required to be without taxes and duties, that price can be the 'retail sale price' [*Explanation* 1 section 4A].

(e) If more than one 'retail sale price' is printed on the same packing, the maximum of such retail price will be considered [Explanation 2(a) to section 4A]. If different MRP are printed on different packages for different areas, each such price will be 'retail sale price' for purpose of valuation [*Explanation* 2(c) to section 4A].

(f) Removing excisable goods without MRP or wrong MRP or tampering, altering or removing MRP declared on a package is an offence and goods are liable to confiscation [section 4A(4)] If price is altered, such increased price will be the 'retail sale price' for purpose of valuation [*Explanation* 2(b) to section 4A].

For example, Government had issued a notification to the effect that excise duty on 'cosmetics and toilet preparations' will be payable on the basis of MRP printed on retail carton after allowing abatement of 40%. In such case, if MRP printed on carton is Rs 200 and if the duty on 'cosmetics & toilet preparations' is 16% plus education cess of 2% plus SAH education cess of 1%, the duty @ 16% will be payable on Rs 120 (i.e. after allowing 40% abatement on MRP of Rs 200). Thus duty payable per pack will be Rs 19.20, plus education cess Rs 0.38 plus SAH education cess of Rs 0.19.

MRP provisions are overriding provisions – Section 4A(2) of Central Excise Act uses the words 'notwithstanding section 4'. Hence, when section 4A is applicable, provisions of section 4 for determination of assessable value are not applicable.

Provision of MRP based valuation are applicable only when product is statutorily covered both under Weights and Measures Act and notification issued under CEA - reiterated in *Swan Sweets* v. *CCE* 2006 (198) ELT 565 (CESTAT).

Same product sold in wholesale and under MRP - CBE&C has clarified in circular No. 737/53/2003-CX dated 19-8-2003 that when goods covered u/s 4A are supplied in bulk to large buyer (and not in retail), valuation is required to be done u/s 4. Provisions of section 4A apply only where manufacturer is legally obliged to print MRP on the packages of goods. Thus, there can be instances where the same commodity would be partly assessed on basis of section 4A and partly on basis of transaction value u/s 4.

Products covered under the MRP valuation scheme - So far, 96 articles have been covered under this scheme [Notification No. 2/2006-CE(NT) dated 1-3-2006.

Non-applicability of provisions of MRP - If an article is not covered under provisions in respect of marking MRP, provisions of duty payable on basis of MRP do not apply and in those cases, duty will be payable on *ad valorem* basis as per section 4. As per rules 2A and 34 of Standards of Weights and Measures (Packaged Commodities) Rules, 1977 (as amended w.e.f. 14-1-2007), the provisions of marking MRP are not applicable to following commodities – Packages above 25Kg (50 Kg in case of cement) * Packaged commodities for industrial or institutional consumers * Small packages of 10gm/10 ml or less * Fast food items * Scheduled drugs and formulations * Agricultural farm produce * Bidis for retail sale * Domestic LPG gas.

Deemed Manufacture of products covered under MRP - In respect of goods specified in third schedule to Central Excise Act, any process which involves packing or repacking of such goods in a unit container or labelling or re-labelling of containers including the declaration or alteration of retail sale price on the container or adoption of any other treatment on the goods to render the product marketable to consumer will be 'manufacture'. [section 2(f)(iii) effective from 14-5-2003].

1.4 DUTY ON AD VALOREM BASIS

If a product Central Excise is payable on the basis of value. This is called "**ad valorem duty**". The 'assessable value' is arrived at on the basis of Section 4 of the Central Excise Act and duty is payable on the basis of such value. Assessable Value (AV) is the '***Value***' on which duty is payable as a percentage.

- When duty is payable on *ad valorem* basis, it is payable on assessable value as defined in section 4 of CEA.
- 'Transaction Value' is taken as Assessable Value if goods are sold at the time and place of removal, buyer is unrelated and price is sole consideration.
- Transaction value is the price paid or payable for the goods 'by reason of, or in connection with sale'.
- Transaction value does not include duty of excise, sales tax and any other taxes on goods.
- If goods are cleared without payment of duty, the price is taken as 'cum duty' price and tax payable should be calculated by back calculations.

The basic provisions of new Section 4(1)(a) state that 'assessable value' when duty of excise is chargeable on excisable goods with reference to value will be 'transaction value' on each removal of goods, if following conditions are satisfied -

- The goods should be sold at the time and place of removal.
- Buyer and assessee should not be related.
- Price should be the *sole consideration* for the sale.
- Each removal will be treated as a separate transaction and 'value' for each removal will be separately fixed.

Following are main requirements of 'transaction value'.

- Price actually paid or payable
- Price is for the goods
- Price includes any amount that the buyer is liable to pay to, or on behalf of assessee. Thus, payment made by buyer to another person, on behalf of assessee, will be includible.
- The payment should be 'by reason of, or in connection with the sale'. As explained later, these terms have always been construed strictly in judicial interpretation.
- The amount may be payable at the time of sale or at any other time. Such time may be before or after sale.
- Any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter is includible. However, these expenses are includible only when aforesaid conditions are satisfied i.e. (a) The amount should be paid or payable to assessee or on behalf of assessee and (b) Payment should be by reason of sale or in connection with sale.
- Amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods is to be excluded while calculating 'transaction value'. The amount may be 'payable' any time in the future.

1.4.1 Inclusions in assessable value

- An amount charged is includible in assessable value if it is by reason of or in connection with sale of such goods.
- Duty is payable on packing charges and design charges related to manufacture.
- Duty is payable in case of price escalation after clearance, but not when price was final at the time of clearance.
- Trade discount is allowable as deduction from assessable value.

- Transport charges upto place of removal are includible in assessable value.
- Notional interest on advances is includible only if there is evidence that it has depressed the selling price.

1.4.2 Bought out goods, accessories for valuation

- Price of Bought out goods supplied along with manufactured goods is includible if these are essential part of manufactured goods.
- Price of accessories and optional bought out items is not includible in Assessable Value.

1.4.3 Valuation Rules

- If transaction value is not acceptable, valuation is required to be done as per Valuation Rules [Rule 3]
- Valuation can be done on value of 'such' goods (i.e. goods of same class of same manufacturer) [Rule 4]
- Cost of transport upto 'place of removal' is includible not beyond that [Rule 5]
- If price is not sole consideration, money value of other consideration should be added e.g. Cost of material, patterns, dies, designs etc. supplied by buyer is required to be added to Assessable Value [rule 6].
- In case of depot sale, duty is payable on basis of depot price prevailing at the time of removal of final product from the factory [Rule 7]
- In case of captive consumption, duty is payable on basis of cost of production plus 10%. Cost of Production should be calculated on basis of CAS-4 [Rule 8]
- In case of entire sale through related buyer, valuation should be on basis of price at which related buyer sales goods to unrelated buyer [Rule 9 and 10]
- In case of job work, valuation is done on the basis of price at which raw material supplier (Principal Manufacturer) sales the manufactured final product in market [Rule 10A inserted w.e.f. 1-4-2007
- In other cases, on basis of 'best judgment' assessment, i.e. value shall be determined using reasonable means consistent with the principles and general provisions of Valuation rules and sub-section (1) of section 4 of the Act [Rule 11]

1.5 OTHER IMPORTANT PROVISIONS

Other important provisions are summarized below.

1.5.1 Refund of excise duty

- Assessee can claim refund of duty within one year from relevant date u/s 11B, in form R.
- Refund is subject to doctrine of unjust enrichment, i.e. refund will be available only if the amount was not recovered from buyer. These are overriding provisions.
- Doctrine of unjust enrichment applies to captive consumption, provisional assessment and also when duty was paid under protest.
- If refund is delayed beyond three months, interest is payable @ 6% p.a.

1.5.2 Exemption from Duty

- Section 5A(1) of Central Excise Act and section 25(1) of Customs Act empower Central government to exempt any excisable goods from duty, by issuing notification in Official Gazette.
- Such exemption may be partial or full, conditional or unconditional.
- Absolute i.e. unconditional exemption is compulsory, while conditional notification is at option of assessee.
- Central Government can also grant exemptions in exceptional cases u/s 5A(2).
- An exemption notification should be strictly construed, but purposeful construction is permissible.
- Principle of promissory estoppel can apply to an exemption notification.

1.5.3 Exemption to SSI

- SSI are eligible for exemption from duty under Notification No. 8/2003-CE dated 1-3-2003. The SSI unit need not be registered with any authority.
- Broadly, items generally manufactured by SSI (except in tobacco, matches and textile sector) are eligible for SSI exemption. Some items like pan masala, matches, watches, tobacco products, Power driven pumps for water not confirming to BIS, products covered under compounded levy scheme etc. are specifically excluded, even when these can be manufactured by SSI. Some items like automobiles, primary iron and steel etc. are not eligible for SSI exemption, but anyway, these are beyond capacity of SSI unit to manufacture.
- Unit whose turnover was less that Rs 4 crores in previous year are entitled to full exemption upto Rs 150 lakhs in current financial year.
- SSI units manufacturing goods with brand name of others are not eligible for exemption,

unless the goods are manufactured in rural area.

- Turnover of all units belonging to a manufacturer will be clubbed for calculating SSI exemption limit.
- Clubbing is also possible if two units are sham or bogus or if there is unity of interest and practically they are one.

While calculating limit of Rs 400/150 lakhs -

- Turnover of Exports, deemed exports, turnover of non-excisable goods, goods manufactured with other's brand name and cleared on full payment of duty, job work done under notification No. 214/86-CE, 83/94-CE and 84/94-CE, processing not amounting to manufacture, strips of plastics used within factory is to be excluded.
- Value of intermediate products (when final product is exempt under notification other than SSI exemption notification), branded goods manufactured in rural area and cleared without payment of duty, export to Nepal and Bhutan and goods cleared on payment of duty is to be included.
- Value of turnover of goods exempted under notification (other than SSI exemption notification or job work exemption notification) is to be included for purpose of limit of Rs 400 lakhs, but excluded for limit of Rs 150 lakhs.

1.5.4 Captive consumption

- Excise duty is payable on goods manufactured and used within the factory.
- The intermediate product manufactured within the factory is exempt from duty, if it is consumed captively for manufacture of (*a*) Capital goods as defined in Cenvat Credit Rules i.e. those which are eligible for Cenvat credit *or* (*b*) Used for in or in relation to manufacture of final products eligible for Cenvat, made from inputs which are eligible for Cenvat. [Notification No. 67/1995 dated 16-3-1995].
- Duty is payable only if intermediate goods are marketable.
- If duty is payable on intermediate products, valuation will be on basis of cost of production plus 10%.
- Cost of production should be calculated on basis of CAS-4.

1.5.5 Job work under Central Excise

- Since excise duty is on manufacture, duty will be payable even if goods are manufactured on job work basis.
- Job Work means processing or working upon of raw materials or semi-finished goods supplied to job worker, so as to complete a part or whole of the process resulting in the manufacture or finishing of an article or any operation which is essential for the aforesaid process – *Explanation* I to Notification No. 214/86-CE dated 25-3-86 – same definition in

rule 2(n) of Cenvat Credit Rules.

- As per rule 10A of Valuation Rules inserted w.e.f. 1-4-2007, duty is payable on the basis of price at which raw material supplier sales the final product in the market.
- If product is covered under MRP, duty is payable as per section 4A.
- Job work is exempt if material is sent to job worker under Cenvat Credit Rule 4(5)(a).
- Job work is exempt if material was sent under Cenvat provisions or under notification No. 214/86-CE. The supplier of raw materials or semi-finished goods has to give an undertaking that he will discharge the duty on final product.
- Service tax is payable on Job work if (a) Activity is not manufacture or (b) Material is not sent under Cenvat provisions.

1.5.6 EA 2000 Excise Audit

An Audit section is attached to each Commissionerate. Audit of assessee's factory is carried out by visit by 'audit party'. The Audit Party usually consist of 2/3 inspectors and a Deputy Office Superintendent, headed by a Excise Superintendent. The audit system is termed as 'EA-2000' [Excise Audit 2000]

The frequency of audit will be on basis of excise duty paid annually. The 'duty paid' means paid by cash plus through Cenvat credit. The frequency is as follows, as per CBE&C letter No. 381/145/2005 dated 6-6-2006 –

- Units paying duty more than Rs three crores – every year.
- Units paying duty between Rs one crore and Rs 3 crores – once every two years.
- Units paying duty between Rs 50 lakhs and Rs one crore – once every five years.
- Units paying duty below Rs 50 lakhs – 10% of units every year.

CERA audit - In addition to departmental audit, C&AG carries out selective audits, which is termed as 'CERA' (Central Revenue Audit').

1.6 PROCEDURES IN CENTRAL EXCISE

Some procedures are basic, which every assessee is required to follow. Besides, some procedures are required to be followed as and when required.

Basic Procedures

(1) Every person who produces or manufactures excisable goods, is required to get registered, unless exempted. [Rule 9 of Central Excise Rules]. If there is any change in information supplied in Form A-1, the same should be supplied in Form A-1.

(2) Manufacturer is required to maintain Daily Stock Account (DSA) of goods manufactured, cleared and in stock. [Rule 10 of Central Excise Rules]

(3) Goods must be cleared under Invoice of assessee , duly authenticated by the owner or his authorised agent. In case of cigarettes, invoice should be countersigned by Excise officer. [Rule 11 of Central Excise Rules]

(4) Duty is payable on monthly basis through GAR-7 challan / Cenvat credit by 5th/6th of following month, except in March. SSI units have to pay duty on monthly basis by 15th/16th of following month. Assessee paying duty through PLA more than Rs 50 lakhs per annum is required to make e-payment only [Rule 8].

(5) Monthly return in form ER-1 should be filed by 10th of following month. SSI units have to file quarterly return in form ER-3. [Rule 12 of Central Excise Rules] - - EOU/STP units to file monthly return in form ER-2 – see rule 17(3) of CE Rules

(6) Assessees paying duty of Rs one crore or more per annum through PLA are required to submit Annual Financial Information Statement for each financial year by 30th November of succeeding year in prescribed form ER-4 [rule 12(2) of Central Excise Rules].

(7) Specified assessees are required to submit Information relating to Principal Inputs every year before 30th April in form ER-5, to Superintendent of Central Excise. Return for 2004-05 was required to be submitted by 31-12-2004 [rule 9A(1) to Cenvat Credit rules inserted w.e.f. 25-11-2004]. Any alteration in principal inputs is also required to be submitted to Superintendent of Central Excise in form ER-5 within 15 days [rule 9A(2) to Cenvat Credit rules inserted w.e.f. 25-11-2004]. Only assessees manufacturing goods under specified tariff heading are required to submit the return. The specified tariff headings are – 22, 28 to 30, 32, 34, 38 to 40, 48, 72 to 74, 76, 84, 85, 87, 90 and 94; 54.02, 54.03, 55.01, 55.02, 55.03, 55.04. Even in case of assessees manufacturing those products, only assessees paying duty of Rs one crore or more through PLA (current account) are required to submit the return.

(8) Assessee who is required to submit ER-5 is also required to submit monthly return of receipt and consumption of each of Principal Inputs in form ER-6 to Superintendent of Central Excise by tenth of following month [rule 9A(3) to Cenvat Credit rules inserted w.e.f. 25-11-2004]. *Only those assessees who are required to submit ER-5 return are required to submit ER-6 return.*

(9) Every assessee is required to submit a list in duplicate of records maintained in respect of transactions of receipt, purchase, sales or delivery of goods including inputs and capital goods, input services and financial records and statements including trial balance [Rule 22(2)].

(10) Inform change in boundary of premises, address, name of authorised person, change in name of partners, directors or Managing Director in form A-1. [*Refer* Instructions given below form A-1]

These are core procedures which each assessee has to follow. There are other procedures which are not routine.

Non-core procedures - The non-core procedures are as follows -

(a) Export without payment of duty or under claim of rebate [Rules 18 and 19 of Central Excise Rules]

(b) Receipt of goods for repairs / reconditioning [Rule 16 of Central Excise Rules]

(c) Receipt of Goods at concessional rate of duty for manufacture of Excisable Goods.

(d) Payment of duty under Compounded Levy Scheme

(e) Provisional Assessment [Rule 7 of Central Excise Rules]

(f) Warehousing of goods.

(g) Appeals and settlement.

1.6.1 Invoice for removal of final products

Rule 11(1) of Central Excise Rules provides that excisable goods can be removed from factory or warehouse only under an 'Invoice' signed by owner or his authorised agent. In case of cigarettes, invoice shall be counter-signed by Inspector. Invoice should bear serial number and should be in triplicate.

As per Rule 11(2) of Central Excise Rules, Invoice shall contain –

(a) Registration Number

(b) Address of jurisdictional Central Excise Division.

(c) Name of consignee

(d) Description and classification of goods

(e) Time and date of removal

(f) Mode of transport and vehicle registration number

(g) Rate of duty

(h) Quantity and Value of goods

(i) Duty payable on the goods.

1.6.2 Export Procedures

- Exports are free from taxes and duties.
- Goods can be exported without payment of excise duty under bond under rule 19 or un-

der claim of rebate of duty under rule 18.

- Excisable Goods should be exported under cover of Invoice and ARE-1 form.
- Merchant exporter has to execute a bond and issue CT-1 so that goods can be cleared without payment of duty. Manufacturer has to issue Letter of Undertaking.
- Export to Nepal / Bhutan are required to be made on payment of excise duty.
- EOU has to issue CT-3 certificate for obtaining inputs without payment of excise duty.

1.6.3 Bringing goods for repairs, re-making etc.

- Duty paid goods can be brought in factory for being re-made, refined, reconditioned or for any other reason under rule 16.
- The goods need not have been manufactured by assessee himself.
- Cenvat credit of duty paid on such goods can be taken, on basis of duty paying documents of such goods.
- After processing / repairs, if the process amounts to 'manufacture', excise duty based on assessable value is payable.
- If process does not amount to manufacture, an 'amount' equal to Cenvat credit availed should be paid [rule 16(2)].
- If some self manufactured components are used, duty will have to be paid on such components.
- Buyer / recipient of such goods can avail Cenvat credit of such amount / duty.
- If the above procedure cannot be followed, permission of Commissioner is required [rule 16(3)].

1.6.4 Receipt of Goods at concessional rate of duty

Some users of excisable goods can obtain goods at nil or lower rate of duty, subject to certain conditions. In other words, the exemption is based on end use. If the buyer is entitled to obtain excisable goods at nil or concessional rate of duty, he is required to follow prescribed procedure. The provisions are contained in Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 2001.

1.6.5 Returns to be filed

Form of Return	Description		Who is required to file
ER-1 [Rule 12(1) of Central Excise Rules]	Monthly Return by large units	Manufacturers not eligible for SSI concession	10th of following month
ER-2 [Rule 12(1) of Central Excise Rules]	Return by EOU	EOU units	10th of following month
ER-3 [Proviso to Rule 12(1) of Central Excise Rules]	Quarterly Return by SSI	Assessees availing SSI concession	20th of next month of the quarter
ER-4 [rule 12(2) of Central Excise Rules]	Annual Financial Information Statement	Assessees paying duty of Rs one crore or more per annum through PLA	Annually by 30th November of succeeding year
ER-5 [Rules 9A(1) and 9A(2) of Cenvat Credit Rules]	Information relating to Principal Inputs	Assessees paying duty of Rs one crore or more per annum through PLA and manufacturing goods under specified tariff headings	Annually, by 30th April for the current year (e.g. return for 2005-06 is to be filed by 30-4-2005].
ER-6 [Rule 9A(3) of Cenvat Credit Rules]	Monthly return of receipt and consumption of each of Principal Inputs	Assessees required to submit ER-5 return	10th of following month

1.7 DEMANDS, PENALTIES AND APPEALS

1.7.1 Demands of Excise Duty

- If duty is short paid or not paid or erroneously refunded, show cause notice can be issued u/s 11A(1) of CEA within one year from 'relevant date'.
- In case of allegation of suppression of facts, wilful misstatement, fraud or collusion, the show cause notice can be issued within five years.
- Show cause notice is to be issued by authority who is empowered to adjudicate the case.
- Adjudicating authority is required to follow principles of natural justice. He has to pass orders with reasons
- In case of delay in payment of duty, interest @ 13% is payable u/s 11AB(1) of CEA.
- Property of person to whom show cause notice has been issued can be attached provisionally during adjudication, to protect interest of revenue.

Adjudication powers - The adjudication powers are as follows -

Authority	Issue of SCN and Demand of duty	Remission of duty for loss of goods	Other powers
Commissioner	Without limit	Without limit	
Additional Commissioner	Between Rs 20 lakhs to 50 lakhs	Rs 5,00,000	Cases relating matters under *proviso* to section 35B(1) i.e. export under bond or under claim of rebate, loss of goods during transit to warehouse - without upper monetary limit
Joint Commissioner	Between Rs 5 lakhs to 50 lakhs	Rs 5,00,000	Cases relating matters under *proviso* to section 35B(1) i.e. export under bond or under claim of rebate, loss of goods during transit to warehouse - without upper monetary limit
Deputy/ Assistant Commissioner	Upto Rs 5 lakhs	Rs 1,00,000	(1) Issue registration certificate (2) Refund claim without limit
Superintendent	No powers	Upto Rs 10,000	

Note (1) Demand of duty or differential duty may be relating to * determination of valuation and / or classification or * Cenvat credit cases or * duty short paid or not paid or erroneously refunded for any reason. Such demand may or may not contain for allegation of fraud, suppression of facts etc. (in other words, whether or not there is allegation of fraud / suppression of facts etc., the monetary limit of adjudication remains same.

Note (2) As per CBE&C circular No. 809 / 6 / 2005-CX dated 1-3-2005, in case of refund claim, AC / DC can pass order without any monetary limit. However, claims of Rs 5 lakhs and above will be subject to pre-audit at level of jurisdictional Commissioner

Note (3) It has been clarified that value of goods / conveyance, plants, machinery, land, building etc. liable to confiscation will not alter the powers of adjudication as the powers solely depend upon the amount of duty / Cenvat credit involved on the offending goods].

Who can issue show cause notice - Show cause notice should be approved and signed by officer empowered to adjudicate the case.

1.7.2 Appeals

Excise and Customs Law empower excise / customs officers to pass adjudication orders demanding duty and interest and imposing penalty and confiscation of goods.

Excise and Customs Act have made elaborate provisions for appeals against adjudication orders passed by excise / customs authorities. There is only one appeal in case of orders of Commissioner, while in case of other orders (i.e. orders of Superintendent, Assistant Commissioner, Dy. Commissioner, Jt. Commissioner, and Additional Commissioner), first appeal is with Commissioner (Appeals) and other with Tribunal. In some matters, revision application lies with Government against order of Commissioner and Commissioner (Appeals).

Tribunal is final fact finding authority and no further appeal lies against facts as found by Tribunal (CESTAT). In case of order of Tribunal relating to classification or valuation, appeal lies with Supreme Court. In other matters, appeal can be made to High Court only if substantial question of law is involved.

Pre-deposit for filing appeal **-** Section 35F of Central Excise Act (similar section 129E of Customs Act) provides that person desirous of appealing against the order shall, *pending the appeal*, deposit the duty demanded or penalty levied. In case of customs, pre-deposit of duty, interest and penalty is required. However, the appellate authority [Commissioner (Appeals) or Appellate Tribunal] is empowered to dispense with such deposit if it is of the opinion that the deposit of duty or penalty will cause undue hardship to the person. Such waiver may be subject to such conditions as may be imposed to safeguard interests of revenue.

Meaning of 'duty demanded' - As per *explanation* to section 35F of CEA (inserted w.e.f. 11-5-2007), 'duty demanded' shall include following – (i) amount determined u / s 11D (ii) amount of erroneous Cenvat credit taken (iii) amount payable under earlier Central Excise Rule 57cc (iv) amount payable under rule 6 of Cenvat Credit Rules (v) Interest payable under provisions of Central Excise Act and Rules.

Coercive action for recovery when stay application pending - CBE&C has issued a circular that if stay application is pending with Commissioner (Appeals), coercive action for recovery of dues will not be initiated - CBE&C Circular No. 396/29/98-CX dated 2-6-1998. In a further circular No.788/21/2004-CX dated 25-5-04, it has been clarified same principle should apply in respect of appeals lying with Tribunal against original order of Commissioner

1.8 IMPORTANT PROVISIONS OF CENTRAL EXCISE ACT, 1944

Section No.	Brief Contents
2(d)	'Excisable Goods' means goods specified in the Schedule to Central Excise Tariff Act, 1985 as being subject to a duty of excise and includes salt. *Explanation* - 'goods' includes any article, material or substance which is capable of being bought and sold for a consideration and such goods shall be deemed to be marketable
2(e)	'Factory' means any premises, including the precincts thereof, wherein or in any part of which, excisable goods other than salt are manufactured; or wherein or in any part of which any manufacturing process connected with production of these goods is being carried on or is *ordinarily* carried on.
2(f)	*"Manufacture"* includes any process - (*i*) incidental or ancillary to the completion of manufactured product; (*ii*) which is specified in relation to any goods in the Section or Chapter notes of the First Schedule to the Central Excise Tariff Act, 1985 as amounting to manufacture; *or (iii)* which, in relation to goods specified in Third Schedule to the CEA, involves packing or repacking of such goods in a unit container or labelling or re-labelling of containers or declaration or alteration of retail sale price or any other treatment to render the product marketable to consumer; - - and the word 'manufacturer' shall be construed accordingly and shall include not only a person who employs hired labour in the production or manufacture of excisable goods, but also any person who engages in their production or manufacture on his own account. *[Clauses (ii) and (iii) are called deemed manufacture]*. The definition of 'manufacture' is inclusive and not exhaustive.

2 (h)	'Sale' and 'purchase' with their grammatical variations and cognate expressions, means any transfer of possession of goods by one person to another in the ordinary course of trade or business for cash or deferred payment or other valuation consideration.
3 (1) (a)	This section is the 'charging section' of 'basic excise duty' and reads as follows - There shall be **levied and collected** in such manner as may be prescribed duties on all excisable goods (*excluding goods produced or manufactured in special economic zones*) which are produced or manufactured in India as, and at the rates, set forth in the First Schedule to the Central Excise Tariff Act, 1985.
3 (2)	Central Government can fix tariff values for purpose of levying excise duty. Once tariff value is fixed, valuation section 4 will not apply, as made clear in section 4(2).
3A	On goods to be notified by Central Government, duty will be payable on the basis of annual capacity of production. The production capacity will be determined by Assistant/Deputy Commissioner on the basis of rules. The provision will not apply to goods manufactured by EOU.
4 (1)	Where under this Act, the duty of excise is chargeable on any excisable goods with reference to their value, then, on each removal of the goods, such value shall—(*a*) in a case where the goods are sold by the assessee, for delivery at the time and place of the removal, the assessee and the buyer of the goods are not related and the price is the sole consideration for the sale, be the transaction value; (*b*) in any other case, including the case where the goods are not sold, be the value determined in such manner as may be prescribed.
Explanation to section 4(1)	Price actually paid to assessee (less sales tax and other taxes) will be price-cum-duty and shall be deemed to include the duty payable on such goods.
4 (3) (b)	Persons shall be deemed to be 'related' if – (i) They are inter-connected undertakings (ii) They are relatives (iii) Amongst them, buyer is a relative and a distributor of assessee, or a sub-distributor of such distributor or (iv)They are so associated that they have interest, directly or indirectly, in the business of each other. *Explanation* (i) inter-connected undertakings shall have meaning assigned to it in section 2(g) of Monopolies and Restrictive Trade Practices Act, 1969 (MRTP) (ii) 'relative' shall have meaning assigned to it in section 2(41) of the Companies Act.

4(3)(c)	'Place of removal' means - (i) a factory or any other place or premises of production or manufacture of the excisable goods from where such goods are removed (ii) A warehouse or any other place or premises wherein the excisable goods have been permitted to be deposited without payment of duty from where such goods are removed (iii) A depot, premises of a consignment agent or any other place or premises from where excisable goods are to be sold after their clearance from factory; from where such goods are removed.
4(3)(cc)	"Time of removal", in respect of the excisable goods removed from the place of removal referred to in sub-clause (iii) of clause (c), shall be deemed to be the time at which such goods are cleared from the factory
4(3)(d)	'Transaction value' means the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to, or on behalf of, the assessee, by reason of, or in connection with the sale, whether payable at the time of sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter; but does not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.
4A	Section 4A of CEA empowers Central Government to specify goods on which duty will be payable based on 'retail sale price'. The provisions for valuation on MRP basis are as follows - (a) The goods should be covered under provisions of Standards of Weights and Measures Act or Rules [section 4A(1)]. (b) Central Government has to issue a notification in Official Gazette specifying the commodities to which the provision is applicable and the abatements permissible. Central Government can permit reasonable abatement (deductions) from the 'retail sale price' [section 4A(2)]. (c) While allowing such abatement, Central Government shall take into account excise duty, sales tax and other taxes payable on the goods [section 4A(3)]. (d) The 'retail sale price' should be the maximum price at which excisable goods in packaged forms are sold to ultimate consumer. It includes all taxes, freight, transport charges, commission payable to dealers and all charges towards advertisement, delivery, packing, forwarding charges etc. If under certain law, MRP is required to be without taxes and duties, that price can be the 'retail sale price' [*Explanation* 1 section 4A]. (e) If more than one 'retail sale price' is printed on the same packing, the maximum of such retail price will be considered [Explanation 2(a) to section 4A]. If different MRP are printed on different packages for different areas, each such price will be 'retail sale price' for purpose of valuation [*Explanation* 2(c) to section 4A]. (f) Removing excisable goods without MRP or wrong MRP or tampering, altering or removing MRP declared on a package is an offence and goods are liable to confiscation [section 4A(4)] If price is altered, such increased price will be the 'retail sale price' for purpose of valuation [*Explanation* 2(b) to section 4A].

5	Government can provide for remission of duty of excise payable on excisable goods, which due to any natural cause, are found to be deficient in quantity, by making rules in that behalf (Rule 21 provides for remission of duty)
5A(1)	Central Government can exempt any excisable goods, (*a*) generally (*b*) either absolutely or subject to such conditions (to be fulfilled before or after removal), (*c*) from whole or any part of excise duty leviable. Such exemption should be in public interest and it should be by way of a notification published in Official Gazette.
Proviso to section 5A(1)	**The exemption notification issued u/s 5A is not applicable in respect of DTA clearances by EOU unit, unless specifically provided in the notification.**
5A(1A)	Absolute i.e. unconditional exemption is compulsory.
5A(2)	Central Government can grant exemption, in public interest, in exceptional circumstances by a special order (This is *ad hoc* exemption and can be granted even retrospectively)
5A(2A)	Central Government, for the purpose of clarifying the scope or applicability of exemption notification or exemption order, may insert an explanation to the exemption notification or order within one year of such notification or order. Such Explanation to an exemption Notification will have retrospective effect from date of exemption notification.
5A(3)	Partial exemption under section 5A(1) or 5A(2) can be granted by providing exemption from duty at a rate expressed in form or method different from which statutory duty is leviable. However, the duty prescribed by an exemption notification can never exceed the *Statutory Duty*.
6	Registration is required to be obtained by any prescribed person who is engaged in (*a*) every manufacturer or producer of excisable goods i.e. goods specified in First or Second Schedule to Central Excise Tariff Act and (*b*) wholesale purchase or sale (whether on his own account or as broker or commission agent) or storage of any specified goods included in First or Second Schedule to Central Excise Tariff Act – Rule 9 makes provisions in respect of registration.

9(1)	**Following are offences punishable with imprisonment and fine -** **(i) Contravening provisions of restrictions of possession of goods in excess of prescribed quantity as prescribed under section 8.** (a) Evading payment of duty payable under CEA. (b) Removing excisable goods or concerning himself with such removal, in contravention of provisions of Central Excise Act and Rules. (c) Acquiring or in any way concerning himself with transporting, depositing, concealing, selling, purchasing or otherwise dealing with excisable goods where he knows or has reason to believe that the goods are liable to confiscation under Central Excise Act or Rules. (d) Contravening any provision of Central Excise Act or rules in relation to Cenvat credit. (e) Failure to supply information or knowingly supplying false information. (f) Attempting to commit or abetting commission of an offence regarding evasion of duty or transit of goods or restriction on storage of goods or non-registration of a unit. Punishment imposable is imprisonment upto seven years and fine (without limit) if (*a*) the duty leviable on the excisable goods exceeds one lakh of rupees [section 9(1) *or* (*b*) a person already convicted for offence under Central Excise Act is convicted again [section 9(2)]
9C	Mens rea (culpable mental state) shall be presumed by Court. Accused can prove that he had no culpable mental state.
11	**Excise authorities can recover excise duty by any of the following means –** • **Adjusting against money payable to the person (e.g. if refund is due to him)** • **By attachment and sale of excisable goods belonging to the assessee.** • **As Arrears of Land Revenue, by issuing certificate to District Collector of Revenue, who is empowered to recover the amount as arrears of land revenue.**

Proviso to section 11	If a person transfers his business or trade or disposes of his business to a third person, any duty or any other sum due from predecessor can be recovered from successor in trade or business, by attaching all goods, materials, preparations, plants, machineries, vessels, utensils, implements and articles which was transferred to the successor.
11A(1)	Central Excise Officer can, within one year from relevant date, serve show cause notice on person chargeable to duty, if – (a) duty of excise has not been levied or paid or (b) short levied or paid or (c) erroneously refunded. The show cause notice should ask the person why he should not pay the amount specified in the notice.
Proviso to section 11A (1)].	In case of fraud, collusion, wilful mis-statement and suppression of facts, or contravention of any provision of Central Excise Act or rules with intent to evade payment of duty, demand for duty can be raised within 5 years
11A(1A)	Where notice has been served on assessee under proviso to section 11A (1) of Central Excise Act (CEA), for short payment or non-payment of duty on account of fraud, collusion or wilful misstatement or suppression, the person to whom notice is service can pay full duty or in part as accepted to him within 30 days. In addition, he should pay interest payable under section 11AB of Central Excise Act and penalty equal to 25% of excise duty specified in the notice or 25% of duty as acceptable to him. In such cases, other persons to whom notices have been sent shall be deemed to be concluded, as per *proviso* to section 11A (2) of Central Excise Act.
11A(2)	After considering representation of the person on whom notice is served, the central excise officer will determine the duty payable and then the person shall pay the duty so determined
11A(2B)	If assessee pays duty due on his own, the officer shall not issue any show cause notice. However, if the officer is of the opinion that there is short payment in respect of the amount, he can issue notice for payment of balance amount. In such case, the time limit for issue of show cause notice will be counted from the receipt of information of payment. Further, the provision does not apply if the short payment or non-payment or erroneous refund was due to collusion, wilful mis-statement or suppression of facts.

11A(3)(ii)	The prescribed period for service of show cause notice cum demand is one year or 5 years from "relevant date". The relevant date will be one of the following ➢ If Return is to be filed as per provision of law, the actual date of filing of return [section 11A(3)(ii)(a)(A)]. ➢ If the return was required to be filed but was not filed, then the date on which return should have been filed [section 11A(3)(ii)(a)(B)]. ➢ If no return is required to be filed under the relevant provisions of Excise law, then date of payment of duty [section 11A(3)(ii)(a)(C)]. ➢ In case of provisional assessment, date of adjustment of duty after final adjustment [section 11A(3)(ii)(b)]. ➢ In case of demand on account of erroneous refund, dare of such refund [section 11A(3)(ii)(c)].
11AB(1)	If duty is not paid when it ought to have been paid, interest is payable at the rates specified by Central Government by notification in Official Gazette (present rate is 13% w.e.f. 12-9-2003). The interest is payable from the first day of the month following the month in which the duty ought to have been paid, till the date of payment.
11AC	A mandatory penalty equal to the duty short paid or not paid or erroneously refunded is payable if such non-payment or short payment or erroneous refund was due to fraud, collusion, wilful mis-statement or suppression of facts etc. If duty and interest along with penalty is paid within 30 days, penalty will be 25% [There is dispute whether the penalty is mandatory or can be reduced in deserving cases].
11B(1)	Person claiming refund of excise duty and interest, if any, paid on such duty, to make application within one year of 'relevant date' to AC / DC. The limitation of one year shall not apply if duty was paid under protest.
11B(2)	Doctrine of unjust enrichment – Refund, after sanction, to be credited to Consumer Welfare Fund.
Proviso to section 11B(2)	Refund will be paid to assessee only in following cases – • Rebate of excisable goods exported out of India (if he had exported on payment of duty) • Rebate of excise on excisable materials used in manufacture of goods exported out of India (if he has not availed Cenvat credit) • Refund of duty paid on inputs (if payable according to any rule or notification) • To Manufacturer, if he has not passed on incidence of the duty to another person • To Buyer, if he has borne the duty **and** if he has not passed on incidence of the duty to another person • To any other class of applicant if borne by any such class of applicants, as may be notified by Government of India, if the incidence of duty has not been passed on to any other person (not specified so far)

11B(3)	Section 11B(2) to have overriding effect over any judgment or rule
Explanation B to section 11B	**Relevant date for purpose calculation of period of one year for filing refund claim is as under:** **(a) In case of exports (*a*) when the ships or aircraft leaves India (*b*) if the goods are exported by land, the date on which the goods leave Indian frontier (*c*) if export is by post, date of despatch of goods by post office to a place outside India.** **(b) If Compound levy scheme is applicable, if assessee pays the full duty and if rate is subsequently reduced by Government, then date on which notification regarding reduction of rate is published.** **(c) In case of refund claim filed by purchaser, date of purchase of the goods** **(d) If duty is exempted by a special order under section 5A(2), the date of issue of such order** **(e) If duty was paid on provisional basis, the date of adjustment of duty after final assessment of duty.** **(f) Where duty becomes refundable as a consequence of judgment, decree, order or direction of appellate authority, CESTAT or any Court, date of such judgment, decree, order or direction (This clause inserted by Finance Act, 2007 w.e.f. 11-5-2007)** **(g) In other cases, date of payment of duty**

11BB	Interest on delayed refund if not paid within three months from date of receipt of application u/s 11B(1), at rate notified (Presently, 6% w.e.f. 12-9-2003). As per *explanation*, order for refund by Commissioner (Appeals), Tribunal or Court, refund is also deemed to be an order passed u/s 11B(2).
11C	***Exemption if duty not paid as per past general practice*** - If (*a*) there was a *generally prevalent practice* of levy or non-levy of any excisable goods *and* (*b*) such goods were *actually* liable for duty at higher rates; Central Government may, by notification in Official Gazette, direct that such excess duty payable, need not be paid.
11D(1)	*Duty collected from buyer must be paid* - Every person, who is liable to pay duty under Central Excise Act and Rules and has collected from buyer any amount in excess of the duty assessed or determined and paid on any excisable goods under CE Act or rules, representing as duty of excise; must pay the amount immediately (forthwith) to the credit of Central Government
11D(1A)	Every person who has collected from buyer any amount in excess of the duty assessed or determined and paid on any excisable goods under CE Act or rules, representing as duty of excise; must pay the amount immediately (forthwith) to the credit of Central Government.
11DD	Interest on amount payable under section 11D
11DDA	Provisional attachment of property of a person to whom show cause notice has been serviced under sections 11A or 11D of Central Excise Act, if the Central Excise Officer (or customs officer as the case may be) is of the opinion that it is necessary to do so, to protect interests of revenue.
12	Central Government can apply provisions of Customs Act regarding levy, exemption, drawback, warehousing, offences, penalties, confiscation and procedure relating to offences and appeal to Central Excise, making suitable modifications and alterations to adapt them to circumstances.
12A	Every person liable to pay duty of excise, shall prominently indicate in all documents relating to assessment, sales invoice and other like documents, the amount of duty, which forms part of the price at which such goods are sold. (This is also required under rule 11(2) of Central Excise Rules).
12B	Every person who had paid duty shall be deemed to have passed on the burden to buyer of the goods.
12C	Constitution of Consumer Welfare Fund. Section 12D provides that the fund should be utilised for welfare of consumers.
12E(1)	Central Excise Officer can exercise powers and discharge duties conferred on CE officer subordinate to him.

13	Powers of arrest with prior approval of Commissioner
14(1)	Powers to issue summons to a person to attend and give evidence or produce document.
14A and 14AA	Special audit by Cost Accountant of Value u/s 14AA and of Cenvat credit u/s 14AA
18	Search and arrest under the Act to be made in accordance with Code of Criminal Procedure.
22	Vexatious search and seizure by Central Excise Officer
23A to 23H	Advance ruling
31 and 32 to 32PA	Settlement of Cases
33	Powers of adjudication of confiscation and penalty – Unlimited to Commissioner and limited to lower officers as per limits prescribed by CBE&C
34	Option to pay fine in lieu of confiscation
34A	Even if goods re confiscated or penalty is imposed, other punishment can be imposed.
35(1)	Appeal to Commissioner (Appeals) within 60 days from order of officer lower in rank than Commissioner.
35(1A)	Commissioner (Appeals) can adjourn the hearing but not more than three adjournments can be given.
35A(3)	Commissioner (Appeals) can pass order confirming, modifying or annulling the decision or order appealed against.
35B(1)	Appeal to Tribunal (CESTAT) against order of Commissioner or Commissioner (Appeals).
35B(2)	Committee of Commissioners can direct any Central Excise Officer to file appeal against order passed by Commissioner (Appeals). If there is difference of opinion between two Commissioners, the matter will be referred to jurisdictional Chief Commissioner who will decide whether to file appeal
35B(3)	Appeal to be filed within three months from date of communication of order to Commissioner or other party, as the case may be. As per section 35B(5), Tribunal can condone delay in filing appeal if sufficient cause is shown.
35B(4)	Other party can file cross-objection within 45 days from receipt of copy of appeal filed by other party.
35B(6)	Appeal to be filed in prescribed form with prescribed fees.
35C(1A)	Tribunal can give maximum three adjournments.
35C(2)	Tribunal can correct a mistake apparent from record, within six months from date of order, if mistake brought to notice by Commissioner or other party.

35D(3)	Single member bench can determine issue if duty involved or amount of fine / penalty involved is less than Rs 10 lakhs. However, issue relating to rate of duty or value cannot be determined by a single member bench.
35E(1)	Committee of two Chief Commissioners can direct any Commissioner to apply to Tribunal for the determination of points arising out of order of Commissioner of Central Excise (This will be treated as departmental appeal). If there is difference of opinion between two Chief Commissioners, the matter will be referred to CBE&C (Board) who will decide whether to file appeal As per section 35E(3), order directing to file appeal shall be made within three months from date of communication of order. After that, as per section 35E(4), authorised officer should file appeal with Tribunal within one month.
35E(2)	Commissioner can direct any excise officer subordinate to him to apply to Commissioner (Appeals) for the determination of points arising out of order of an adjudicating authority subordinate to him (This will be treated as departmental appeal). As per section 35E(3), order directing to file appeal shall be made within three months from date of communication of order. After that, as per section 35E(4), authorised officer should file appeal with Commissioner (Appeals) within one month..
35EE(1)	In case of following order of Commissioner or Commissioner (Appeals), appeal does not lie with Tribunal, but revision application can be made to Central Government - (*a*) loss of goods occurring in transit from factory to warehouse or to another factory (*b*) rebate of duty on goods exported outside India or excisable goods used in manufacture of goods which are exported and (*c*) goods exported without payment of duty.
35EE(2)	Revision application should be filed within three months from date of communication of order. Delay upto three months can be condoned by Central Government.
35F	Duty, penalty, interest, erroneous Cenvat credit or 'amount' to be deposited pending appeal. Pre-deposit can be dispensed with if it may cause undue hardship to assessee.
35FF	If the amount deposited u / s 35F becomes refundable pursuance to order passed by Commissioner (Appeals) or Tribunal, the amount should be refunded within three months from date of communication of the order to adjudicating authority. If not so refunded, interest is payable at the rate specified in section 11BB of the Act
35G(1)	Appeal to High Court on substantial question of law. Appeal to High Court can be made if the order of CESTAT *does not* relate, among other things, to the determination of any question having a relation to rate of duty or to value of goods. Appeal to be filed within 180 days. Appeal against judgment of High Court lies with SC u / s 35L(a)(i).

35L(b)	Appeal to Supreme Court, if the order of CESTAT relates, among other things, to the determination of any question having a relation to rate of duty or to value of goods.
35Q	Appearance of authorised representative before Central Excise Officer or Tribunal.
36A	Documents produced by a person or seized from him shall be presumed to be true. Document will be admissible as evidence even if not duly stamped.
36B	Microfilms, fax copies and computer print puts will be admissible as evidence.
37B	Board empowered to issue orders, instructions and directions to Central Excise Officers for purposes of uniformity in the classification of excisable goods or with respect to levy of excise duties on such goods. However, such order cannot require central excise officer to make assessment in a particular way or interfere with discretion of Commissioner (Appeals).
37C	Any decision or order passed or any summons or notice under the Act shall be served (*a*) by tendering the same or by sending it with registered post with acknowledgement due to the person for whom it is intended or his authorised agent (*b*) If it cannot be served as aforesaid, then by affixing a copy at a conspicuous space in factory or warehouse. (*c*) If this is also not possible, then affixing a copy on the notice board of the office or authority which issued the notice, order, summons or decision.
37D	Duty, interest, penalty or fine to be rounded off to nearest rupee
Third Schedule	List of goods where packing, repacking, labelling etc. will amount to manufacture u/s 2(f)(iii) [These are same goods which are covered under MRP provisions under section 4A].

1.9 IMPORTANT PROVISIONS OF CENTRAL EXCISE RULES, 2002

Rule No.	Brief Contents
2(b)	'Assessment' includes self-assessment of duty made by the assessee and provisional assessment made under rule 7.
2(c)	'Assessee' means any person who is liable for payment of duty assessed or a producer or manufacturer of excisable goods or a registered person of a private warehouse in which excisable goods are stored, and includes an authorized agent of such person.
2(ea)	A taxpayer who is registered under Central Excise or Service tax provisions and is an assessee under Income Tax Act and has PAN number, and who fulfils prescribed conditions is 'Large Tax payer'.
5	Duty will be payable at rate and valuation as applicable at the time of actual removal from factory or warehouse, except in case of khandsari molasses [rule 5(1)]. Rate of duty applicable in case of khandsari molasses shall be the rate in force on date of receipt of such molasses in the factory of the procurer of such molasses [Rule 5(2)].
6	Assessee shall himself assess the duty payable on excisable goods, except that that in case of cigarettes, the Superintendent or Inspector of Central Excise shall assess the duty payable before removal of goods.
7	**Provisional assessment can be requested by the assessee. Department cannot itself order provisional assessment. Final assessment will be made later by Assistant / Deputy Commissioner after getting the required details.**
8	Duty is payable by 5th of following month (6th in case of e-payment). SSI units availing SSI exemption have to pay duty by 15th of following month (16th in case of e-payment). For the month of March, duty is payable by 31st March, both by large units as well as SSI
8(2)	Duty is deemed to have been paid for purpose of availment of Cenvat credit by the buyer
8(3)	If duty is not paid fully on due date, assessee is liable to pay the outstanding amount along with interest on unpaid amount at the rate specified under section 11AB. If part of duty is paid, the provision of interest will apply to that part of duty which is not paid [present rate of interest is 13%]
8(3A)	**If duty and interest is not paid within 30 days after due date, assessee will forfeit the facility to pay duty in monthly instalments. He will have to pay duty through PLA before clearance of goods. He cannot utilise Cenvat credit for payment of duty during that period. This forfeiture of facility is automatic and mandatory. If despite such restrictions, assessee clears goods without payment of duty and consequences and penalties as applicable for removal of goods without payment of duty will follow.**

9(1)	every person who produces, manufactures, carries on trade, holds private store-room or warehouse or otherwise uses excisable goods shall get registered.
9(2)	Board is authorised to issue notifications (a) specifying conditions and procedures for registration and (b) granting exemption to person or class of persons from provisions of registration.
10(1)	***Daily Stock Account of manufactured goods*** **-** A daily stock of goods manufactured or produced has to be maintained by every assessee.
10(2) and 10(3)	The first page and last page of such account book shall be duly authenticated by the producer or manufacturer or his authorised agent [rule 10(2)]. All such records shall be preserved for 5 years [rule 10(3)].
11(1)	Goods should be removed from a factory or warehouse only under an invoice signed by owner or his authorised agent. In case of cigarettes, invoice shall be counter-signed by Inspector.
11(2)	Invoice shall contain Registration Number, Address of jurisdictional Central Excise Division (added w.e.f. 1-4-2007), Name of consignee, Description and classification of goods, Time and date of removal, Mode of transport and vehicle registration number, Rate of duty, Quantity and Value of goods and Duty payable on the goods.
11(3)	Invoice should be in triplicate and should be marked as follows (*i*) Original shall be marked 'ORIGINAL FOR BUYER' (*ii*) Duplicate copy shall be marked 'DUPLICATE FOR TRANSPORTER' (*iii*) Triplicate shall be marked 'TRIPLICATE FOR ASSESSEE'.
11(4)	Only one copy of invoice book at a time, unless otherwise allowed by AC / DC.
11(5)	Each foil of the Invoice shall be pre-authenticated by the assessee - by owner, working partner, Managing Director or Secretary or any person duly authorised for this purpose, before being brought into use.
11(6)	Before making use of the invoice book, serial numbers shall be intimated to Range Superintendent.
11(7)	Provisions of rule 11 (which is applicable to manufacturers) shall apply *mutatis mutandis* to goods supplied by a first stage dealer or a second stage dealer.
Proviso to rule 11(7)	If a first stage or second stage dealer receives goods under an invoice which mentions that Cenvat credit of the special CVD paid u / s 3(5) of Customs Tariff Act is not admissible, he should make similar endorsement in his invoice to buyer.
12(1)	A monthly return is to be submitted by every assessee to Superintendent of Central Excise, of production and removal of goods, and Cenvat credit availed, by 10th of the following month in form ER-1. SSI unit availing concession on basis of annual turnover have to file return on quarterly basis within 20 days from close of quarter in form ER-3.

12(2)	Assessees paying duty of Rs one crore or more per annum through PLA are required to submit Annual Financial Information Statement for each financial year by 30th November of succeeding year in prescribed form ER-4.
12(3)	The Range Officer will scrutinise the monthly / quarterly return. He can call for documents from the assessee as he considers necessary.
12(4)	It will be responsibility of assessee to provide necessary records as and when required by excise officer.
12AA	Procedure for job work in articles of jewellery.
12BB	Procedures by LTU (Large Taxpayer Unit]
15	Central Government can notify scheme for payment of duty under 'Compounded Levy Scheme'.
16	Duty paid goods can be brought in factory for being re-made, refined, reconditioned or for any other reason under rule 16(1). After processing / repairs, if the process amounts to 'manufacture', excise duty based on assessable value is payable. If process does not amount to manufacture, an 'amount' equal to Cenvat credit availed should be paid. [rule 16(2)]. If the above procedure cannot be followed, permission of Commissioner is required [rule 16(3)].
16C	A manufacturer can, with specific permission of Commissioner, remove excisable goods manufactured in his factory for carrying out tests or any other process not amounting to manufacture, to some other premises, without payment of duty. The provision does not apply to prototype which are sent out for trial or development test. Conditions as specified in permission of Commissioner of CE will have to be followed [The rule is useful in cases where Cenvat provisions do not apply].
17	EOU to clear goods under invoice and duty is payable at the time of removal (not on monthly basis).
18	Duties can be paid on final product and subsequently rebate (refund) is claimed after exportation of such goods. Alternatively, rebate can be granted of duty paid on inputs used in the exported final product and final product is exported without payment of excise duty.
19	Excisable goods can be removed for export without payment of duty [Rule 19(1)]. Inputs to be used for manufacture of final product to be exported can be obtained without payment of excise duty [Rule 19(2)].
20	Facility of warehousing for removal of excisable goods from factory of production to a warehouse or from one warehouse to another warehouse without payment of duty. CBE&C can prescribe conditions, limitations and safeguards.

21	**Remission of duty can be granted in following cases –** **(a) Goods have been lost or destroyed by natural causes** **(b) Goods have been lost or destroyed by unavoidable accident** **(c) Goods are claimed by manufacturer as unfit for consumption or for marketing.**
22(2)	Every assessee and first stage dealer and second stage dealer should submit a list in duplicate, of specified records prepared or maintained by him.
23	Power to stop and search conveyance
24	Power to detain or seize goods
25	**Following are offences for which goods can be confiscated and penalty upto duty on contravening excisable goods or Rs 2,000, whichever is higher, can be imposed.** **(i) Removing excisable goods in contravention of Excise Rules or notifications issued under the rules [rule 25(1)(a)].** **(ii) Not accounting for excisable goods manufactured, produced or stored [rule 25(1)(b)].** **(iii) Engaging in manufacture, production or storage of excisable goods without applying for registration certificate u/s 6 of CE Act [rule 25(1)(c)].** (iv) **Contravening any provision of Central Excise Rules or notifications issued under these rules *with intent to evade* payment of duty [rule 25(1)(d)].**
26(1)	***Personal penalty for knowingly dealing in goods liable to confiscation*** - Any person who acquires possession of, or is in any way concerned in transporting, removing, depositing, keeping, concealing, selling or purchasing, or in any other manner deals with any excisable goods which he knows or has reason to believe are liable to confiscation under the Act or rules, shall be liable to a penalty upto the duty payable on such goods or Rs 2,000 whichever is greater.
26(2)	Penalty for issuing false invoice or document for availing ineligible Cenvat credit, upto amount of benefit or Rs 5,000 whichever is higher.
27	***Residual penalty*** - for breach of any excise rule, if no penalty has been prescribed, the penalty would be Rs. 5,000 plus confiscation of goods in respect of which offence has been committed.

1.10 IMPORTANT RULES OF CENTRAL EXCISE VALUATION RULES, 2000

Rule No.	Brief Contents
2(b)	"Normal transaction value" means the transaction value at which the greatest aggregate quantity of goods are sold.
	If goods are not sold at the time of removal, then value will be based on the value of ***such goods*** sold by assessee at any other time nearest to the time of removal, subject to reasonable adjustments.
5	Some times, goods may be sold at place other than the place of removal e.g. in case of FOR delivery contract. In such cases, actual cost of transportation from place of removal upto place of delivery of the excisable goods will be allowable as deduction. Cost of transportation can be either on actual basis or on equalized basis.
6	If price is not the sole consideration for sale, the 'Assessable Value' will be the price charged by assessee, plus money value of the additional consideration received. **The buyer may supply any of the following directly or indirectly, free or at reduced cost.** **(a) Materials, components, parts and similar items** **(b) Tools, dies, moulds, drawings, blue prints, technical maps and charts and similar items used** **(c) Material consumed, including packaging materials** **(d) Engineering, development, art work, design work and plans and sketches undertaken elsewhere than in the factory of production and necessary for the production of the goods** In such cases, value of such additional consideration will be added to the price charged by assessee to arrive at the 'transaction value'. [*explanation* 1 to Rule 6].
Explanation 2 to rule 6	Where an assessee receives any advance payment from the buyer against delivery of any excisable goods, no notional interest on such advance shall be added to the value unless the Central Excise Officer has evidence to the effect that the advance received has influenced the fixation of the price of the goods.
7	When goods are sold through depot, there is no 'sale' at the time of removal from factory. In such cases, price prevailing at depot (but at the time of removal from factory) shall be the basis of Assessable Value. The value should be 'normal transaction value' of such goods sold from the depot at the time of removal or at the nearest time of removal from factory.
8	In case of captive consumption, valuation shall be done on basis of cost of production plus 10% (Cost of production is required to be calculated as per CAS-4)

9	If entire production is sold to 'related person' other than inter-connected undertakings, the assessable value will be 'normal transaction value' at which the related person sells the goods to unrelated buyers.
Proviso to rule 9	If assessee sales goods to 'related person', but related person uses them in captive consumption (and not sell them), valuation will be done on basis of cost of production plus 10%, as per rule 8.
10	If entire production is sold to 'related person' who are inter-connected undertakings, the assessable value will be as follows – (a) If they are 'related person' as defined in other clauses or is a holding or subsidiary company of assessee, 'normal transaction value' at which the related person sells the goods to unrelated buyers (b) In other cases, the value will be as if they are not 'related person'
10A	In case of job worker manufacturing goods on behalf of Principal Manufacturer, value will be the value at which the Principal Manufacturer sales goods to unrelated buyer. 'Job worker' means a person engaged in manufacture or production of goods on behalf of a principal manufacturer, from any inputs or capital goods supplied by the said principal manufacturer or by any other person authorised by him.
11	***Residuary method*** - If value cannot be determined under any of the foregoing rules, value shall be determined using reasonable means consistent with the principles and general provisions of section 4 and Valuation Rules.

1.11 RULES OF CLASSIFICATION

General Rules for Interpretation of Schedule to Central Excise Tariff and Customs Tariff are given in First Schedule to the Tariff. The rules are same for excise and customs. The highlights of rules are given below.

Rule	Brief contents
1	Classification shall be determined according to the terms of the headings and any relative section or chapter notes and, provided such headings or Notes do not otherwise require, according to other provisions of the rules
First part of rule 2(a)	Any reference to complete goods also includes incomplete or un-finished goods, if such incomplete or un-finished goods have the essential characteristic of finished goods.
Second part of rule 2(a)	Heading will also include finished goods removed un-assembled or disassembled i.e. in SKD or CKD packs.

2(b)	Any reference in heading to material or substance will also include the reference to mixture or combination of that material or substance with other materials or substance. The classification of goods consisting of more than one material or substance shall be according to the principles contained in rule 3.
3	When by application of sub-rule (b) of rule 2 or for any other reason, goods are, *prima facie*, classifiable under two or more headings, classification shall be effected as given in rule 3(a), 3(b) or 3(c).
3(a)	The heading which provides most specific description shall be preferred to heading providing a general description.
3(b)	If Mixture and Composite goods consisting of different materials or different components cannot be classified based on above rule i.e. rule 3(a), it should be classified as if they consisted of the material or component which gives it their *essential character.*
3(c)	If two or more headings seem equally possible and the dispute cannot be resolved by any of the aforesaid rules, if both the headings appear equally specific, the heading which occurs last in numerical order is to be preferred (*i.e. latter the better*).
4	**If the classification is not possible by any of the aforesaid rules 1, 2 and 3, then it should be classified under the heading appropriate to goods to which they are most akin. [This is only a last resort and a desperate remedy to resolve the classification issue]**
5	**cases for camera, musical instruments, drawing instruments, necklaces etc. specially shaped for that article, suitable for long term use will be classified along with that article, if such articles are normally sold along with such cases. Further, packing materials and containers are also to be classified with the goods *except when the packing is for repetitive use* (This provision is obviously made to ensure that the packing and the goods are charged at same rate of duty).**
6	Classification of goods in sub-headings shall be determined in terms of those sub-headings. Only sub-headings at the same level are comparable

STUDY NOTE - 2

SOME CRITICAL ISSUES IN CENTRAL EXCISE

This Study Note includes

- Software is 'goods' but unbranded software is Service
- Plant and Machinery assembled at Site
- Dutiability of Steel and Concrete Structures
- Goods with Blank Duty Rate in Central Excise Tariff are 'Excisable Goods'
- Manufacture
- Classification of Goods
- MRP based Valuation
- Assessable Value under Section 4
- Other Issues
- Exemption to SSI

2.1 SOFTWARE IS 'GOODS', BUT UNBRANDED SOFTWARE IS SERVICE

In *Tata Consultancy Services* v. *State of Andhra Pradesh* (2005) 1 SCC 308 = 141 Taxman 132 = 271 ITR 401 = AIR 2005 SC 371 = 2004 AIR SCW 6583 = 137 STC 620 = 178 ELT 22 (SC 5 member Constitution bench), it has been held that canned software (i.e. computer software packages sold off the shelf) like Oracle, Lotus, Master-Key etc. are 'goods'. The copyright in the programme may remain with originator of programme, but the moment copies are made and marketed, they become 'goods'. It was held that test to determine whether a property is 'goods' for purpose of sales tax, is not whether the property is tangible or intangible or incorporal. The test is whether the concerned item is capable of abstraction, consumption and use, and whether it can be transmitted, transferred, delivered, stored, possessed etc. Even intellectual property, once it is put on a media, whether it be in form of books or canvas (in case of painting) or computer discs or cassettes and marketed would become goods. In all such cases, intellectual property has been incorporated on a media for purpose of transfer. The buyer is purchasing the intellectual property and not the media, i.e. the paper or cassette or discs or CD. - - There is no distinction between 'branded' and 'unbranded' software. In both cases, the software is capable of being abstracted, consumed and used. In both the cases, the software can be transmitted, transferred, delivered, stores, possessed etc. Unbranded software when marketed / sold may be goods. However, Supreme Court did not express any opinion because in case of unbranded software, other questions like *situs* of contract of sale and / or whether the contract is a service contract may arise. Hence, in case of unbranded software, the issue is not yet fully settled. [SC upheld decision of AP High Court reported in *Tata Consultancy Services* v. *State of AP* (1997) 105 STC 421 (AP HC DB)].

In *Bharat Sanchar Nigam Ltd.* v. *UOI* (2006) 3 SCC 1 = 152 Taxman 135 = 3 STT 245 = 145 STC 91 = 282 ITR 273 (SC 3 member bench), following extract from decision in case of *Tata Consultancy Services* v. *State of Andhra Pradesh* was quoted with approval and adopted, 'A 'goods' may be a tangible property or an intangible one. It would become goods provided it has the attributes

1.1-3 Manufacture

· Taxable event for central excise duty is manufacture or producti
India.

thereof having regard to (a) its utility; (b) capable of being bought and sold and (c) capable of being transferred, delivered, stored and possessed. If a software, whether customised or non-customised satisfies these attributes, the same would be goods'.

Earlier also, in *Associated Cement Companies Ltd.* v. *CC* 2001(4) SCC 593 = 2001 AIR SCW 559 = 128 ELT 21 = AIR 2001 SC 862 = 124 STC 59 (SC 3 member bench), it was held that computer software is 'goods' even if it is copyrightable as intellectual property.

In *State Bank of India* v. *Municipal Corporation* 1997(3) Mh LJ 718 = AIR 1997 Bom 220, it was held that 'computer software' is 'appliance' of computer. It was held that it is 'goods' and octroi can be levied on full value and not on only value of empty floppy. [In this case, it was held that octroi cannot be levied on license fee for duplicating the software for distribution outside the corporation limits].

Excise duty on software - All software, except canned software i.e. software that can be sold off the shelf, is 'exempt' under notification No. 6/2006-CE dated 1-3-2006.

Para 138 of Finance Minister's speech dated 28-2-2006 reads as follows, 'I propose to impose an 8 per cent excise duty on packaged software sold over the counter. Customized software and software packages downloaded from the internet will be exempt from this levy'.

Meaning of 'software' - 'Information Technology Software' is defined in Supplementary Note of chapter 85 of Central Excise Tariff (and also Customs Tariff) as follows - 'For the purpose of heading 8523, 'Information Technology Software' means any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of an automatic data processing machine'.

In *CCE* v. *Pentamedia Graphics* (2006) 198 ELT 164 (SC), it was held that 'motion picture animation file' recorded in a machine readable format and capable of being manipulated by automatic data processing machine is software – referred in *Padmini Polymers* v. *CCE* (2007) 215 ELT 392 (CESTAT), where it was held that multimedia application software on CD ROM is exempt. In this case, Cook Books and games which were interactive were held as 'software'. Reference was made to CBE&C circular No. 7/98-Cus dated 10-2-1998 where it was clarified that encyclopedia, games, books will be 'software' if these satisfy the interactivity criterion.

The SC decision was also followed in *Gayatri Impex* v. *CC* (2007) 215 ELT 397 (CESTAT) and *Adani Exports* v. *CCE* (2007) 210 ELT 443 (CESTAT). However, from the decision, it is not clear what was exactly imported.

There is no requirement that to qualify as software, it must work without any operating system preloaded on computer. Any programme which requires anther programme like operating system will also be treated as software – *Contessa Commercial Co. P Ltd.* v. *CC* (2007) 208 ELT 299 (CESTAT). In this case, the importer had imported educational programmes and games.

Classification of encyclopedia, books on CD - In case of encyclopedia and books, there is hardly any 'interactivity', except that search engine helps in locating particular information. Further, search engine, which can be termed as 'software' forms insignificant part of the whole goods.

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Applying the criteria of 'essential character' in case of mixture of goods, in my view, these cannot be termed as 'software'. These have to be classified as books.

Note 2 to chapter 49 reads as follows, 'For the purpose of Chapter 49, the term 'printed' also means reproduced by means of a duplicating machine, produced under the control of an automatic data processing machine, embossed, photographed, photocopies, thermocopied or typewritten. Hence, it can be argued that a book can be 'printed' on CD since it is produced under the control of an automatic data processing machine.

As per item Sr. No. 26 of Notification No. 6/2006-CE dated 1-3-2006, CD-ROMs containing books of an educational nature, journal, periodicals (magazines) or newspaper are fully exempt from excise duty. Thus, a book can be on CD has been recognised in law.

2.1.1 Unbranded software is service

Though Supreme Court has held that tailor made software is also goods, Finance Bill, 2008 has imposed service tax on tailor made i.e. unbranded software.

"Information technology software" means any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of a computer or an automatic data processing machine or any other device or equipment [proposed section 65(53a) of Finance Bill, 2008]

Any service provided or to be provided to any person, by any other person in relation to information technology software for use in the course, or furtherance, of business or commerce, including,— (*i*) development of information technology software, (*ii*) study, analysis, design and programming of information technology software, (*iii*) adaptation, upgradation, enhancement, implementation and other similar services related to information technology software, (*iv*) providing advice, consultancy and assistance on matters related to information technology software, including conducting feasibility studies on implementation of a system, specifications for a database design, guidance and assistance during the startup phase of a new system, specifications to secure a database, advice on proprietary information technology software (*v*) acquiring the right to use information technology software for commercial exploitation including right to reproduce, distribute and sell information technology software and right to use software components for the creation of and inclusion in other information technology software products (*vi*) acquiring the right to use information technology software supplied electronically, is a taxable service [proposed section 65(105)(zzzze) of Finance Bill, 2008]

Departmental clarification – CBE&C TRU letter F. No.334/1/2008-TRU dated 29-1-2008 clarifies as follows -

2.1.2 Software consists of carrier medium such as CD, Floppy and coded data. Softwares are categorized as "normal software" and "specific software". Normalised software is mass market product generally available in packaged form off the shelf in retail outlets. Specific software is tailored to the specific requirement of the customer and is known as customized software.

2.1.3 Packaged software sold off the shelf, being treated as goods, is leviable to excise duty @ 8%. In this budget, it has been increased from 8% to 12% vide notification No. 12/2008-CE dated 01.03.2008. Number of IT services and IT enabled services (ITeS) are already leviable to service tax under various taxable services:

- Consulting engineer's service - advice, consultancy or technical assistance in the disci pline of hardware engineering [section 65(105)(g)].
- Management or business consultant's service - procurement and management of infor mation technology resources [section 65(65)].
- Management, maintenance or repair service - maintenance of software, both packaged and customized and hardware [section 65(64)].
- Banking and other financial services - 'provision and transfer of information and data processing' [section 65(12)].
- Business support service - various outsourced IT and IT enabled services [section 65(105)(zzzq)].
- Business auxiliary service - services provided on behalf of the client such as call centres [section 65(19)].

2.1.4 IT software services provided for use in business or commerce are covered under the scope of the proposed service. Said services provided for use, other than in business or commerce, such as services provided to individuals for personal use, continue to be outside the scope of service tax levy. Service tax paid shall be available as input credit under Cenvat credit Scheme.

2.1.5 Software and upgrades of software are also supplied electronically, known as digital delivery. Taxation is to be neutral and should not depend on forms of delivery. Such supply of IT software electronically shall be covered within the scope of the proposed service.

2.1.6 With the proposed levy on IT software services, information technology related services will get covered comprehensively.

2.2 PLANT AND MACHINERY ASSEMBLED AT SITE

Plant and Machinery assembled and erected at site cannot be treated as 'goods' for the purpose of Excise duty, if it is not marketable and movable. [It may be noted that even if goods are held as 'excisable', they will be exempt if manufactured within factory of production. See case law under 'Captive Consumption' in later chapter].

The word 'goods' applies to those which can be brought to market for being bought and sold, and it is implied that it applies to such goods as are movable. Goods erected and installed in the premises and embedded to earth cease to be goods and cannot be held to be excisable goods. - *Quality Steel Tubes (P.) Ltd.* v. *CCE* 75 ELT 17 (SC) = (1995) 2 SCC 372 = 6 RLT 131 = 1995 AIR SCW 11 - in this case, it was held that tube mill and welding head erected and installed in the premises and embedded in the earth for manufacture of steel tubes and pipes are not 'goods'.

[followed in *Mittal Works* v. *CCE* (1997) 1 SCC 203 = 1996 (88) ELT 622 (SC) = 106 STC 201 - quoted with approval in *Thermax Ltd.* v. *CCE* 1998(99) ELT 481 (SC) - same view in *Triveni Engineering* v. *CCE* AIR 2000 SC 2896 = 2000 AIR SCW 3144 = 40 RLT 1 = 120 ELT 273 (SC) * *CCE* v. *Damodar Ropeways* 2003(151) ELT 3 = 54 RLT 125 (SC 3 member bench).

In *Municipal Corporation of Greater Bombay* v. *Indian Oil Corporation* AIR 1991 SC 686 = 1991 Supp (2) SCC 18, it was held that if the chattel is movable to another place in the same position (condition?), it is movable property. If it has to be dismantled and re-erected at later place, it is attached to earth and is immovable property.

Assembly at site is not manufacture, if immovable product emerges - In *Mittal Engg Works* v. *CCE* 1996 (88) ELT 622 = 17 RLT 612 = 106 STC 201 = (1997) 1 SCC 203, it was held that if an article has to be assembled, erected and attached to the earth at site and if it is not capable of being sold as it is, without anything more, it is not 'goods'. Erection and installation of a plant is not excisable - followed in *CCE* v. *Hyderabad Race Club* 1996 (88) ELT 633 (SC), where it was held that an article embedded in the earth was not 'goods' and hence excise duty is not leviable – followed in *TTG Industries* v. *CCE* 2004 AIR SCW 3329 = 167 ELT 501 (SC) – same view in case of storage cabinets, kitchen counters etc. erected at site in *Craft Interiors P Ltd.* v. *CCE* 2006 (203) ELT 529 (SC) – same view in respect of refrigeration plant, air conditioning plant and caustic soda plant in *CCE* v. *Virdi Brothers* 2007 (207) ELT 321 (SC).

Capital Goods manufactured within factory of production are exempt even if manufactured by third party - It may be noted that capital goods manufactured within the factory and used within the factory are exempt from excise duty *vide* notification No. 67 / 1995-CE dated 16.3.1995. The exemption is available even when the capital goods are manufactured in the factory of production by third party. [see case law under 'Captive Consumption'].

Assembly is manufacture only if machinery can be removed without dis-assembly - In *Triveni Engineering* v. *CCE* AIR 2000 SC 2896 = 2000 AIR SCW 3144 = 40 RLT 1 = 120 ELT 273 (SC), it was observed, 'The marketability test requires that the goods as such should be in a position to be taken to market and sold. If they have to be separated, the test is not satisfied'. [Thus, if machine has to be dis-assembled for removal, it is not 'goods' and duty cannot be levied].

If machine (generating set in this case) is only bolted on a frame and is capable of being shifted from that place, it is capable of being sold. It is goods and not immovable property – *Mallur Siddeswara Spinning Mills* v. *CCE* 2004 (166) ELT 154 (SC).

Present legal position in respect of machinery erected at site – The latest judgment on the issue is of *Triveni Engineering* judgment dated 8-8-2000, which has been practically accepted by Board *vide* its circular dated 15-1-2002. Hence, the present legal provision is, as decided in *Triveni Engineering*, i.e. 'The marketability test requires that the goods ***as such*** should be in a position to be taken to market and sold. If they have to be separated, the test is not satisfied'. Thus, if machinery has to be dismantled before removal, it will not be goods. Following is also clear - (a) Duty cannot be levied on immovable property (b) If plant is so embedded to earth that it is not possible to move it without dismantling, no duty can be levied (c) If machinery is superficially attached to earth for operational efficiency, and can be easily removed without dismantling, duty is leviable (d) Turnkey projects are not dutiable, but individual component / machinery will be dutiable, if marketable.

Article can be 'goods' if marketable before erection - An article will be liable to duty if its manufacture is complete before it is fastened to earth. Similarly, if 'machinery' is in marketable condition at the time of removal from factory of manufacture, duty will be leviable, even if subsequently, it is to be fastened to earth.

2.3 DUTIABILITY OF STEEL AND CONCRETE STRUCTURES

Following are covered in 'iron and steel structure' as defined in tariff heading 7308 – (i) big structures like bridges, transmission towers, and lattice masts, lock-gates, roofs etc. of iron and steel (ii) parts of structures e.g. doors, windows and their frames, shutters, balustrades, pillars and columns etc. of iron and steel (iii) Plates, rods, angles, shapes, sections, tubes and the like prepared for use in structures of iron and steel.

In *Mahindra & Mahindra Ltd.* v. *CCE* 2005 (190) ELT 301 (CESTAT 3 member LB), it has been held as follows –

(i) Immovable iron and steel structures are not goods.

(ii) Structures and parts mentioned in parenthesis of 7308 like bridges, lock-gates, towers, trusses, columns frames etc., *in their movable state* will be subject to excise duty, even if latter they get permanently fixed in the structures.

(iii) Plates, rods, angles, sections, tubes and the like, prepared for use in the structures will also be excisable goods subject to duty *in their pre-assembled or disassembled state.*

Fabrication of steel structurals like columns, crane, grinders, trusses amounts to 'manufacture'- *R S Avtar Singh* v. *CCE* (2007) 213 ELT 105 (CESTAT).

Structure for pre-fabricated building is dutiable – Steel structure for prefabricated building is dutiable. – *Mittal Pipe Mfg. Co.* v. *CCE* 2002(146) ELT 624 (CEGAT).

Fabrication of steel structure at site is exempt - As per Sr. No. 64 of notification No. 3/2005-CE dated 24-2-2005, (earlier it was in tariff entry 7308.50), structures fabricated at site of work for use in construction at site are exempt from duty. In *Delhi Tourism* v. *CCE* 1999(114) ELT 421 (CEGAT), it was held that the term 'site' should be given wider meaning and not narrow meaning. Even if structure is cast at different place and brought to site of construction, it will be eligible for exemption.

2.4 GOODS WITH BLANK DUTY RATE IN CENTRAL EXCISE TARIFF ARE 'EXCISABLE GOODS'

Some goods are mentioned in Central Excise Tariff but column of rate of duty is blank (e.g. live animals in Chapter 1, Electrical Energy in chapter 27, Newspaper and maps in Chapter 49).

As per additional note No. 1(c) to Central Excise Tariff, 'tariff item' means description of goods in the list of tariff provisions accompanying either eight-digit number and the rate of duty or eight-digit number with blank in the columns of the rate of duty. Hence, goods where duty rate is blank is excisable goods – para 22 of *Geetanjali Woolens* v. *CCE* (2007) 218 ELT 152 (CESTAT)

[Interestingly, in case of Customs Tariff, the note 1(c) does not make mention of 'blank' rate in the column of rate of duty].

However, in *CCE* v. *Solaris Chemtech* (2007) 9 STT 412 = 214 ELT 481 (SC), it is observed that electricity is not an excisable item.

In excise tariff, rate is 'blank' in items like rice, wheat, soya bean, cotton seed etc. These are 'produced'.

In excise tariff, rate is 'blank' in items like rice, wheat, soya bean, cotton seed etc. These are 'produced'.

Goods mentioned as 'free' in Customs Tariff - In *Associated Cement Companies Ltd.* v. *CC* 2001 AIR SCW 559 = AIR 2001 SC 862 = (2001) 4 SCC 593 = 128 ELT 18 = 124 STC 59 = (SC 3 member bench), it was held that if duty rate specified in Customs Tariff Act is 'FREE' (i.e. no duty is payable), no duty is payable on such goods and hence these are not 'dutiable goods'. [In Central Excise Tariff, the duty rate indicated is 'Nil'. Hence, these are 'excisable goods'].

2.5 MANUFACTURE

Cutting of jumbo rolls of typewriter to make ribbon of standard length and winding on spool and blister packed - In *Kores India* v. *CCE* (2003) 152 ELT 395 (CEGAT), it was held that conversion of jumbo reels of ribbons into spool form to suit particular model and make of typewriting / telex machine is 'manufacture' as new and distinct product emerges – view upheld in *Kores India* v. *CCE* (2005) 1 SCC 385 = 174 ELT 7 (SC) – followed in *CCE* v. *Sohum Industries Ltd.* 2006 (203) ELT 493 (CESTAT).

This decision was discussed in *Anil Dang* v. *CCE* (2007) 213 ELT 29 (CESTAT 3 member bench). It was held that this was no mere cutting and slitting but the roll was spooled on metal spools, plaster packed and sealed with aluminium foils. Hence, this decision will not apply where only slitting and cutting is involved.

Betel Nut to supari powder is not manufacture – Crushing betel nuts into smaller pieces and sweetening them does not result in a distinct product, as 'betel nut remains a betel nut' – *Crane Betel Nut Powder Works* v. *CCE* 2007 (210) ELT 171 = 6 VST 532 (SC) – decision of Tribunal in *CCE* v. *Crane Betel Nut Powder Works* 2005 (187) ELT 106 (CESTAT) is now not valid.

Upgradation of computer system is not manufacture - Upgradation of computer system by increasing its storage / processing capacity by increasing hard disk capacity, RAM or changing processor chip is not manufacture as new goods with different name, character and use do not come into existence. - CBE&C circular No. 454 / 20 / 99-CX dated 12-4-1999 – view confirmed in *Maxim Information Tech* v. *CCE* 2005 (184) ELT 78 (CESTAT) * *CCS Infotech* v. *CCE* (2007) 216 ELT 107 (CESTAT).

2.6 CLASSIFICATION OF GOODS

Classification of parachute coconut oil – In *Amardeo Plastics Industries* v. *CCE* (2007) 210 ELT 360 (CESTAT 2 v. 1 order), on the basis of chapter notes, it was held that parachute coconut oil

is 'vegetable oil' under chapter 15 and not 'preparation for use on the hair', since the marking on package did not say that it is for 'such specialized use', though advertisements did indicate so.

However, in *Shalimar Chemical Works* v. *CST* (2008) 12 VST 485 (WBTT), it has been held that except in a few Southern States, coconut oil is not treated as edible oil for use of daily cooking. In West Bengal, considering consumption pattern, coconut oil cannot be treated as 'edible oil'. It has to be treated as 'hair oil'.

Plastic name plate - Plastic name plate for motor vehicle is to be classified as 'accessory of motor vehicle' in chapter 87 and not 'other articles of plastic' in chapter 39, since 'name plate' is not specified in any heading in chapter 39 – *Pragati Silicons P Ltd.* v. *CCE* (2007) 8 VST 705 = 211 ELT 534 (SC).

Meaning of 'set of articles' – distinction between laptop and desktop – 'Set of article' should consist of more than one item, each complementing the work of another and retaining their individual identity all the time – *CC* v. *Acer India P Ltd.* (2007) 218 ELT 17 (SC). In this case, it was held that a desktop computer is a combination of CPU with monitor, mouse and keyboard as a set. A desktop computer does not lose individual identities of CPU, monitor, mouse and keyboard. Not only they are marketable as separate items but are also used separately. On the other hand, a laptop (notebook computer) comes in an integrated and inseparable form. It is a combination of CPU, monitor, mouse and keyboard. A laptop cannot be said to be set of CPU with monitor mouse and keyboard – confirming Tribunal decision in *CC* v. *Acer India P Ltd.* (2007) 208 ELT 132 (CESTAT).

Software/records/tapes supplied along with equipment – Software imports are exempt from customs duty.

Earlier, Customs and Central Excise Tariff had a note No. 6 which stated that software when presented with the apparatus for which it was intended will be classifiable as software. This note has been deleted w.e.f. 1-1-2007. Hence, software embedded or pre-loaded in machine is to be classified along with the machine. This will also be case when software is brought separately, but as a 'set'. If tangible software e.g. operating software or application software loaded on disk, floppy, CD-ROM etc. is imported, it will be classifiable as software under heading 8523 – CC (Import), Mumbai PN 39/2007 dated 3-12-2007.

In *CC* v. *Hewlett Packard India (Sales) P Ltd.* (2007) 215 ELT 484 (SC), it was held that pre-loaded software in laptop forms integral part of the laptop. Without operating system like windows, the laptop cannot work. Hence, the laptop along with software has to be classified as laptop and values as one unit. Software pre-loaded cannot be classified separately as software (In this case, the importer wanted to classify hard disk along with software as 'software' and refused to give value of software even when called upon to do so. Hence, the decision has to be seen from peculiar facts of the case).

Principles of classification irrelevant for valuation – Classification decides the applicable rate. It is followed by valuation i.e. value at which rate is to be applied. The concept of 'classification' is therefore different from the concept of valuation. Section and chapter notes in Tariff and interpretative rules do not provide guidelines for valuation -*CCE* v. *Frick India Ltd.* (2007) 216 ELT 497 (SC).

2.7 MRP BASED VALUATION

Same product partly sold in retail and partly in wholesale - CBE&C has further clarified in circular No. 737/53/2003-CX dated 19-8-2003 that when goods covered u/s 4A are supplied in bulk to large buyer (and not in retail), valuation is required to be done u/s 4. Provisions of section 4A apply only where manufacturer is legally obliged to print MRP on the packages of goods. Thus, there can be instances where the same commodity would be partly assessed on basis of section 4A and partly on basis of transaction value u/s 4 – view noted and approved in *Jayanti Food Processing* v. *CCE* (2007) 10 STT 375 = 215 ELT 327 (SC).

Valuation on MRP basis even if package is not really intended for retail sale - In *Jayanti Food Processing* v. *CCE* (2007) 10 STT 375 = 215 ELT 327 (SC), it was observed that nature if sale is not the relevant factor for application of section 4A but application would depend on five factors i.e. (i) goods should be excisable goods (ii) They should be such as are sold in the package (iii) There should be requirement of SWM Act or rules or any other law to declare price of such goods relating to their retail price on package (iv) The Central Government must have specified such goods by notification of Official gazette and (v) Valuation of such goods would be as per the declared retail price on the package less the amount of abatement.

In *ITEL Industries P Ltd.* v. *CCE* 2004 (163) ELT 219 (CESTAT 2 v. 1 decision), telephone instruments were supplied to DOT/MTNL in bulk with MRP duly marked. DOT/MTNL lent these to subscribers retaining their ownership. It was held that since goods were packed, the valuation is required to be done u/s 4A on basis of MRP, even if goods were not sold to customers – followed in *BPL Telecom* v. *CCE* (2004) 168 ELT 251 = 60 RLT 664 (CESTAT), where it was held that there is no requirement under Packaged Commodities Rules that goods covered by those provisions must be actually sold in retail – view confirmed in *Jayanti Food Processing* v. *CCE* (2007) 10 STT 375 = 215 ELT 327 (SC).

This was followed in *CCE* v. *Liberty Shoes* (2007) 216 ELT 692 (CESTAT), where it was held that MRP provisions apply even when sale is in bulk to institutional buyers.

Provision does not apply to ice cream sold in bulk - In *Monsanto Manufacturers* v. *CCE* 2006 (193) ELT 495 (CESTAT), it was held that if ice cream is sold in bulk to hotels and not intended for retail sale, valuation will be as per section 4 and not on MRP basis – view confirmed in *Jayanti Food Processing* v. *CCE* (2007) 10 STT 375 = 215 ELT 327 (SC).

Two items in combi-pack with one item free - In *Icon Household Products* v. *CCE* (2007) 216 ELT 579 (CESTAT), assessee was selling Mosquito Repellant Liquid (MRL) and Liquid Vapourising Device (LVD) as combi-pack. MRP was contained only on plastic container of MRL and not on LVD. It was held that this MRP will be taken for valuation of multipack. LVD supplied free in the multipack is not liable to assessment separately – relying on *Himalaya Drug Company* v. *CCE* (2006) 195 ELT 109 (CESTAT) - same view in *CCE* v. *J L Morison* (2008) 223 ELT 655 (CESTAT SMB).

No MRP on free gifts/samples, hence valuation as per section 4 – In *Jayanti Food Processing* v. *CCE* (2007) 10 STT 375 = 215 ELT 327 (SC), assessee as selling Kitkat chocolates to Pepsi. These were distributed as free gift along with Pepsi bottle as a marketing strategy. It was held that

even if product (chocolate) is covered under MRP provisions, since the product was not to be sold in retail, MRP is not required. Hence, valuation should be on basis of section 4.

2.8 ASSESSABLE VALUE UNDER SECTION 4

Factory can be place of removal even if insurance taken by assessee as service to customers - In *Blue Star Ltd.* v. *CCE* (2008) 224 ELT 258 (CESTAT), transport was arranged by assessee since individual customer cannot arrange for transportation. Insurance was taken for safe transport of goods, as a service to customers. It was held that insurance cover cannot be taken as criteria for determining ownership of goods. It was held that there was sale at factory gate and freight is not includible in assessable value.

Minimum charges if assured quantity not purchased, are not part of excise assessable value - In *Jindal Praxair Oxygen* v. *CCE* (2007) 208 ELT 181 (CESTAT), MTOP charges were payable to assessee if buyer fails to purchase minimum quantity assured, as in such cases, assessee is not in position to operate his plant at optimum capacity. It was held that these are not includible in assessable value - followed in *CCE* v. *Praxair India* (2008) 223 ELT 596 (CESTAT).

Place of removal in case of exports – In case of exports, the place of removal is port where export documents are presented to customs office – *Kuntal Granites* v. *CCE* (2007) 215 ELT 515 = 2007 TIOL 930 (CESTAT) – quoted and followed in *Rajasthan Spinning & Weaving Mills* v. *CCE* (2007) 8 STR 575 (CESTAT).

Cash discount admissible whether availed or not - In *CCE* v. *Arvind Mills Ltd.* (2006) 204 ELT 570 (CESTAT 3 member bench), it has been very clearly held that cash discount and finance cost are admissible under new section 4 of CEA also. Differential price represents interest for delayed payment. Cost of finance and cash discount whether availed or not are to be granted as abatement even after 1-7-2000.

Self insurance charges addible - In *Gujarat Borosil* v. *CCE* (2007) 217 ELT 367 (CESTAT), assessee was collecting 7% amount was 'insurance charges'. Actual insurance premium paid was much less. The charge was to cover breakage of goods in transit. It was held that this cannot be permitted as deduction since assessee was not an insurance company.

Valuation of free samples – CBE&C, *vide* circular No. 813/10/2005-CX dated 25-4-2005 has clarified that in case of samples distributed free, valuation should be done on basis of rule 4 i.e. value of similar goods. The revised circular dated 25-4-2005 stating that valuation of samples should be on basis of rule 4, has been upheld as valid in *Indian Drugs Manufacturers' Assn* v. *UOI* (2008) 222 ELT 22 (Bom HC DB).

Valuation in case of stock transfer - In case of stock transfer, value to be adopted is the price prevailing in depot at the time of clearance from factory. Once goods are cleared from factory to depot on payment of duty (on basis of price prevailing at the time of removal from factory), it is not necessary to chase the goods and see at what price the goods were subsequently sold - *CCE* v. *Carborandum Universal Ltd.* (2008) 224 ELT 290 (CESTAT).

Sale to parent company both as spares as well as for maintenance – In *CCE* v. *Aquamall Water Solutions* (2008) 223 ELT 385 (CESTAT), assessee sold its water purifying equipment to its par-

ent company (Eureka Forbes Ltd.). Assessee also supplied parts of the water purifying equipment to its parent company, both for sale as spares and also for maintenance purposes. In case of spares for sale, duty was paid on the basis of selling price of spares of parent company. In case of parts supplied for use in maintenance, duty was paid on the basis of cost of production plus 10%. Department contended that in case of parts supplied for maintenance also, duty should be paid on basis of selling price of parent company. However, Tribunal held that when parts are not sold by parent company, duty should be paid under rule 8 on basis of cost of production plus 10% since no other specific rule to cover this (The decision is based on a Board circular which has since been withdrawn).

Part sale and part consumption – in *Ispat Industries Ltd.* v. *CCE* 2006 (201) ELT 65 (CESTAT), it was held that if goods are partially sold to unrelated buyers and partially supplied to sister concern, valuation should be under rule 4 i.e. on the basis of price at which goods are sold to other independent buyers – relying on *Aquamall Water Solutions* v. *CCE* 2003 (153) ELT 428 (CEGAT).- view upheld in *Ispat Industries* v. *CCE* 2007 (209) ELT 185 (CESTAT 3 member bench).

2.8.1 Valuation in case of job work

Excise duty will not be payable if raw material / semi-finished components are sent for job work under Cenvat provisions or under notification No. 214/86-CE. However, in other cases, if job work results in 'manufacture' of a product, duty will become payable by job worker.

Rule 10A of Valuation Rules, as inserted w.e.f. 1-4-2007 provides that in such cases, excise duty will be payable on the basis of price at which the raw material supplier (termed as 'principal manufacturer' in valuation rules) sales the goods.

Rule 10A has been inserted in the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 to provide that where goods are manufactured by a job-worker on behalf of a person (commonly known as principal manufacturer), the value for payment of excise duty would be based on the sale value at which the principal manufacturer sells the goods, as against the present provision where the value is taken as cost of raw material plus the job charges - *Para 32.1 of DO letter F. No. 334/1/2007-TRU dated 28-2-2007.*

Provisions relating to valuation - The liability to pay duty will rest with the job-worker as per the present practice - *Para 32.2 of DO letter F. No. 334/1/2007-TRU dated 28-2-2007.*

The value in such cases shall be as follows, w.e.f. 1-4-2007 -:

When goods are sold at the factory of job worker by Principal Manufacturer – If the goods are sold by 'Principal Manufacturer' (raw material supplier) from factory of job worker, the value will be the 'transaction value of the goods at which the goods are sold' by the principal manufacturer for delivery at the time of removal of goods from the factory of job-worker.

This would be so if the principal manufacturer and the buyer of the goods are not related and the price is the sole consideration for the sale [rule 10A(i) of Valuation Rules].

Proviso to rule 10A of Valuation Rules clarifies that cost of transport from premises from which goods are sold to place of delivery will not be included in the assessable value.

When goods are sold by Principal Manufacturer from some other place – If goods manufactured by job worker are delivered at other place (e.g. depot, branch, godown etc. of Principal Manufacturer) and sold from there, the valuation will be on the basis of 'normal transaction value of goods sold at or about the same time' by the Principal Manufacturer from such place.

This would be so if the principal manufacturer and the buyer of the goods are not related and the price is the sole consideration for the sale [rule 10A(ii) of Valuation Rules].

Proviso to rule 10A clarifies that cost of transport from premises from which goods are sold to place of delivery will not be included in the assessable value.

This methodology is similar to valuation in case of sale through depot.

When valuation as per rule 10A(i) or 10A(ii) of Valuation Rules is not possible – If valuation is not possible as per rule 10A(i) or 10A(2) of Valuation Rules, 'value' will be determined in accordance with the principles enunciated in the Valuation Rules on a case-to-case basis [rule 10A(iii) of Valuation Rules].

For example, if the excisable goods manufactured on job-work are sold by the principal manufacturer where the price is not the sole consideration for sale, the value of such goods shall be determined in terms of principles laid down in rule 6.

If goods are captively consumed by Principal Manufacturer, valuation can be on basis of rule 8.

Meaning of job worker – As per *Explanation* to rule 10A, for the purposes of rule 10A, 'job worker' means a person engaged in manufacture or production of goods on behalf of a principal manufacturer, from any inputs or capital goods supplied by the said principal manufacturer or by any other person authorised by him.

Question : A Trader supplies raw material of Rs. 1,150 to processor. Processor processes the raw material and supplies finished product to the trader. The processor charges Rs. 450, which include Rs. 350 as processing expenses and Rs. 100 as his (processor's) profit. Transport cost for sending the raw material to the factory of processor is Rs. 50. Transport charges for returning the finished product to the trader from the premises of the processor is Rs. 60. The finished product is sold by the trader at Rs. 2,100 from his premises. He charges Vat separately in his invoice at applicable rates. The rate of duty is 16% plus education cess as applicable. What is the AV, and what is total duty payable ? (*CA Final May 2005 adopted*)

Answer on and after 1-4-2007 : Assessable Value is to be calculated on basis of selling price of trader which is Rs 2,100. This price is to be treated as inclusive of excise duty. Hence, assessable value will be (2,100 x 100) / 116.48 i.e. Rs 1,802.89. Basic excise duty @ 16% will be 288.46. Education Cess (2%) is Rs 5.77 and Secondary and Higher Education Cess is Rs 2.88. Total duty payable will be Rs 297.11.

Answer upto 31-3-2007 - Assessable Value (AV) is Rs. 1,650 (1,150+350+100+50). Duty is not payable on Rs. 1,800, which includes Traders' profit. Since place of the processor is the place of removal of goods, no duty is payable on outward freight of Rs. 60.

Material cost is not required to be added if parent manufacturer had sent material under Cenvat,

as per decision of Supreme Court in *International Auto Ltd.* v. *CCE* 2005 (183) ELT 239 = 68 RLT 341 (SC 3 member bench).

2.8.2 Practical examples

1,500 pieces of a product 'A' were manufactured during the financial year. Its list price (i.e. retail price) is Rs. 250 per piece, exclusive of taxes. The manufacturer offers 20% discount to wholesalers on the list price. During the year, 840 pieces were sold in wholesale, 510 pieces were sold in retail, 35 pieces were distributed as free samples. Balance quantity of 115 pieces was in stock at the end of the year. The rate of duty is 16% plus education cess and SAH education cesses as applicable. What is the total duty paid during the financial year ? Assume that the manufacture is not eligible for SSI concession.

The total selling price is as follows –

Qty	Price	Total
510	250	1,27,500
840	200	1,68,000
35	200	7,000
Total		3,02,500

Duty payable is 16% of Rs 3,02,500 i.e. Rs 48,400, plus education cess @ 2% i.e. Rs 968.00 plus SAH education cess @ 2% is Rs 484.00.

Note – (a) Since 115 pieces were in stock at year end, no duty will be payable. Duty will be payable only when goods are cleared from factory. (b) In case of samples, as per rule 4 of Valuation Rules, value nearest to the time of removal, subject to reasonable adjustments is required to be taken. However, since prices are varying, value nearest to the time of removal may not be ascertainable and will not be acceptable for valuation as the prices are changing. In such case, recourse will be taken to rule 11 of Valuation Rules, i.e. best judgment assessment. We can take recourse to rule 7 and 9 where principle of 'normal transaction value' is accepted, when prices are varying. As per rule 2(b) of Valuation Rules, 'normal transaction value' means the transaction value at which the greatest aggregate quantity of goods are sold. Since greatest quantity of 840 pieces are sold at Rs 200, that will be 'normal transaction value', which can be taken for valuation of free samples.

A manufacturer has appointed brokers for obtaining orders from wholesalers. The brokers procure orders for which they get brokerage of 5% on selling price. Manufacturer sells goods to buyers at Rs. 250 per piece. The price is inclusive of State Vat and Central excise duty. State Vat rate is 4% and excise duty rate is 16% plus education cess and SAH education cess as applicable. What is the AV, and what is duty payable per piece ?

Assume that Assessable Value = Z. No deduction is available in respect of brokerage paid to third parties from Assessable Value.

Since Excise duty is 16%, education cess is 2%, SAH education cess is 1% and State Vat rate is 4%, price including excise will be 1.1648 Z

State Vat @ 4% of 1.1648Z is 0.046592Z. Hence, price inclusive of sales tax and excise duty will be 1.211392Z.

Now, 1.211392Z	=
Hence, Z	=
Check the answer as follows –	
Assessable Value	=
Add duty @ 16.48% of Rs 206.37	=
Add State Vat @ 4% on Rs 240.38 (206.37+34.01)	=
Total Price (Including duty and tax)	=

A manufacturer has to supply a machinery on following terms and conditions : (a) Price of machinery : 3,40,000 (net of taxes and duties) (b) Machinery erection expenses : 26,000 (c) Packing (normally done by him for all machinery) : 4,000 (d) Design and drawing charges relating to manufacture of machinery : 30,000 (Net of taxes and duties) (e) Central Sales Tax @ 4% (f) Central Excise Duty @ 16% plus education cess of 2% plus SAH education cess of 1% (g) Cash discount of Rs. 5,000 will be offered if full payment is received before despatch of goods. (h) the machine will be supplied along with bought out accessories @ Rs. 8,500. The accessories were optional.

You are informed that (a) The buyer made all payment before delivery. (b) The manufacturer incurred cost of Rs. 1,200 in loading the machinery in the truck in his factory. These are not charged separately to buyer. - - Find the 'Assessable Value' and the duty payable.

Erection expenses are not includible in AV. Cash discount is allowable as deduction. Duty is not payable on optional bought out accessories supplied along with the machinery. The cost of Rs 1,200 is already included in the selling price of machinery (as it is not charged separately) and hence is not to be added again.

Hence, AV is Rs 3,69,000 [Rs 3,40,000 + 4,000 + 30,000 – 5,000]. Duty @ 16% will be Rs 59,040, plus education cess @ 2% i.e. Rs 1,180.80 and SAH education cess @ 1% i.e. Rs 590.40.

Find Assessable Value and duty payable. The product is not covered under section 4A. . - Maximum Retail Trade Price : Rs. 1,100/- per unit. - State Vat, Octroi and other Local Taxes : 10% of net price- Cash Discount : 2% - Trade Discount: 8% - Primary and Secondary packing cost included in the above MRP : Rs. 100 - Excise duty rate : 8% *ad valorem* plus education cesses as applicable. (ICWA Inter - December 1997 adopted)

Cash discount Rs 22 (2% of Rs 1,100) and trade discount 88 [8% of Rs 1,100] are available as deduction. Packing cost is not allowable as deduction. Hence, price of excise purposes is Rs 990. [Rs 1,100 – 22 – 88]. - - Now, if X is the assessable value, excise duty is 0.0824 X and price including Excise duty is 1.0824 X. State Vat and local taxes @ 10 % of 1.0824 X will be 0.10824 X. Thus, price inclusive of excise duty and sales tax will be 1.19064 X.

Now,	1.211392Z	= R
Hence,	Z	= R
Check the answer as follows –		
Assessable Value		= R
Add duty @ 16.48% of Rs 206.37		= R
Add State Vat @ 4% on Rs 240.38 (206.37+34.01)		= R
Total Price (Including duty and tax)		= R

A manufacturer has to supply a machinery on following terms and conditions : (a) Price of machinery : 3,40,000 (net of taxes and duties) (b) Machinery erection expenses : 26,000 (c) Packing (normally done by him for all machinery) : 4,000 (d) Design and drawing charges relating to manufacture of machinery : 30,000 (Net of taxes and duties) (e) Central Sales Tax @ 4% (f) Central Excise Duty @ 16% plus education cess of 2% plus SAH education cess of 1% (g) Cash discount of Rs. 5,000 will be offered if full payment is received before despatch of goods. (h) the machine will be supplied along with bought out accessories @ Rs. 8,500. The accessories were optional.

You are informed that (a) The buyer made all payment before delivery. (b) The manufacturer incurred cost of Rs. 1,200 in loading the machinery in the truck in his factory. These are not charged separately to buyer. - - Find the 'Assessable Value' and the duty payable.

Erection expenses are not includible in AV. Cash discount is allowable as deduction. Duty is not payable on optional bought out accessories supplied along with the machinery. The cost of Rs 1,200 is already included in the selling price of machinery (as it is not charged separately) and hence is not to be added again.

Hence, AV is Rs 3,69,000 [Rs 3,40,000 + 4,000 + 30,000 – 5,000]. Duty @ 16% will be Rs 59,040, plus education cess @ 2% i.e. Rs 1,180.80 and SAH education cess @ 1% i.e. Rs 590.40.

Find Assessable Value and duty payable. The product is not covered under section 4A. . - Maximum Retail Trade Price : Rs. 1,100/- per unit. - State Vat, Octroi and other Local Taxes : 10% of net price- Cash Discount : 2% - Trade Discount: 8% - Primary and Secondary packing cost included in the above MRP : Rs. 100 - Excise duty rate : 8% *ad valorem* plus education cesses as applicable. (ICWA Inter - December 1997 adopted)

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Now,	1.19064 X	=	R
Hence,	X	=	R
Excise duty @ 8.24 % of X		=	R
Check the answer as follows –			
Assessable Value		=	R
Add Excise Duty @ 8.24%		=	R
Add State Vat @ 10% on Rs 900 (831.49 + 68.51)		=	R
Selling Price (After allowable deductions)		=	R

Ram & Co. are dealers in engineering goods. They obtained an order for an engineering item 'A'. They quoted a price of Rs 5,000 per piece for 'A' plus Vat at applicable rate. Ram & Co. then approached Laxman & Co. who was manufacturer of engineering items. It was agreed that Ram & Co. will supply raw material required for manufacture of 'A' to Laxman & Co. free of cost. Laxman & Co. will manufacture product 'A' and supply it to Ram & Co. It was agreed that Laxman & Co. will charge Rs 1,500 per piece as their job charges per piece. Other information is as follows – (i) Raw material supplied by Ram & Co. to Laxman & Co. was purchased by Ram & Co. from the manufacturer 'Z'. The breakup of the invoice of 'Z' was as follows – Net Price per Kg of raw material – Rs 40. Excise duty – Rs 6.40 Sales Tax – Rs 1.86. Total – Rs 48.26. Ram & Co. generally sales goods after adding 10% to their purchase price (ii) Product A requires 50 Kg of raw material per piece, including normal wastage of 5%. (iii) Transport charges incurred by Ram & Co. for delivering raw material to factory of Laxman & Co – Rs 100 per piece (iv) Transport charges for returning the finished product to the Ram & Co – Rs 130 per piece. These are paid by Laxman & Co. and recovered from Ram & Co. by issuing a separate debit note. - - The rate of duty is 16% plus education cess as applicable. Who is liable for payment of excise duty ? What will be the assessable value ? [ICWA Inter June 2004 adopted]

The manufacturer is Laxman & Co.

Valuation on and after 1-4-2007 - Duty is payable on basis of selling price of Ram & Co. which is Rs 5,000 per piece. Hence, assessable value will be Rs (5000 x 116.48) / 100 i.e. 4,292.58. Basic duty is Rs 686.81. Education Cess (2%) is Rs 13.74 and Secondary and Higher Education Cess is Rs 6.87. Total duty is Rs 707.42.

2.9 OTHER ISSUES

When two exemption notifications are available, assessee can select either - If applicant is entitled to claim benefit under two different notifications, he can claim more (i.e. better) benefit and it is the *duty* of authorities to grant such benefit to applicant – *Share Medical Care* v. *UOI* 2007 (209) ELT 321 (SC).

Benefit of exemption can be claimed at any stage - Even if an applicant does not claim benefit under a particular exemption notification at initial stage, he is not debarred, prohibited or estopped from claiming such benefit at a later stage - *Share Medical Care* v. *UOI* 2007 (209) ELT 321 (SC) – quoted and followed in *Cipla Ltd.* v. *CC* (2007) 218 ELT 547 (CESTAT), where it was held that benefit of exemption notification can be claimed at appellate stage also.

2.9.1 Manufacturer not liable for duty liability of scrap / waste generated at end of job worker

Earlier rule 57F provided that waste and scrap arising during job work is required to be returned to raw material supplier. New Cenvat Credit Rules make no such provision. Hence, in *Rocket Engineering Corporation* v. *CCE* 2006 (193) ELT 33 (CESTAT), it has been held that the scrap is not required to be returned to raw material supplier and the raw material supplier is not required to pay any duty on the scrap, since Cenvat Credit Rules after 1-4-2000 do not make any such provision – view confirmed in *CCE* v. *Rocket Engineering Corporation* (2008) 223 ELT 347 (Bom HC DB) - followed in *Emco Ltd.* v. *CCE* (2008) 223 ELT 613 (CESTAT).

In *Preetam Enterprises* v. *CCE* 2004 (173) ELT 26 (CESTAT), it was held that even in respect of inputs sent under Cenvat Credit Rules, job worker is manufacturer of scrap and he is liable to pay duty on scrap. Duty on scrap cannot be demanded from raw material supplier after 1-4-2000 – same view in *Rocket Engineering* v. *CCE* 2006 (193) ELT 33 (CESTAT) [Scrap is treated as a final product if mentioned in the Tariff. However, it is 'final product' of job worker and not of raw material supplier].

In *Silicon Cortec* v. CCE (2004) 166 ELT 473 (CESTAT SMB), it has been held that waste and scrap is final product of job worker and he can clear the same on payment of duty.

In *Timken India* v. *CCE* (2007) 215 ELT 182 (CESTAT), it was held that duty liability on scrap is of the job worker. If he is under SSI exemption, no duty is payable by him.

In *GKN Sinter Metals* v. *CCE* 2007 (210) ELT 222 (CESTAT SMB), it was held that if waste and scarp is only burr in nature of floor sweeping, and if there is invisible loss, no duty is required to be paid on such scrap.

2.9.2 Service tax on job work

Job work falls under 'Business Auxiliary Service', if the job work is not 'manufacture'. Service tax will be payable. Job work done under Cenvat provisions is exempt from service tax.

If the job worker is not availing any Cenvat credit of any common input or input services, question does not arise. However, if the job worker is availing Cenvat credit on inputs or input services, he will be liable to pay 8% 'amount' on job charges under rule 6(3) of Cenvat Credit

Rules, or he may have to go in for proportionate reversal of Cenvat Credit as per rule 6(3A) of Cenvat Credit Rules effective from 1-4-2008.

If the job worker thinks that the rule 6(3A) is cumbersome, it may be advisable to pay service tax @ 12.36% on job charges, since the customer will be in a position to avail Cenvat credit.

If job worker charges 8% 'amount', customer cannot avail Cenvat credit, but if job worker charges regular service tax, the customer will be eligible to avail Cenvat credit.

2.10 EXEMPTION TO SSI

Question - An SSI unit (manufacturing goods eligible for benefits of SSI exemption notification) has cleared goods of the value of Rs. 60 lakhs during the financial year 2007-08. The effective rate of Central Excise Duty on the goods manufactured by it is 8% *Ad valorem*. Education cesses are payable at applicable rates. What is the correct amount of duty which the unit should have paid on the above clearances for 2007-08 ? (CA Final - November 1996) (Question adopted)

Answer - (a) If unit intends to avail Cenvat credit on inputs, duty payable is normal duty i.e. 8% of Rs 60 lakhs, i.e. Rs 4,80,000, plus education cess of Rs 9,600 (2% of Rs 4.80 lakhs), plus SAH education cess of Rs 4,800 (1% of Rs 4.80 lakhs).(b) If unit does not intend to avail Cenvat credit on inputs, duty payable is Nil.

Question - The value of excisable goods viz. Iron and Steel articles manufactured by M/s. Alpha Ltd., was Rs. 120 lakhs during the financial year 2007-08, net of taxes and duties. The goods attract 16% *ad valorem* basic duty plus education cess of 2% plus SAH education cess as applicable. Determine the excise duty liability when the assessee opts for 'CENVAT' and 'opts for not to avail CENVAT' under SSI exemption notifications respectively. (ICWA Inter - December 1997 adopted).

Answer - If the assessee does not avail Cenvat, duty payable is Nil. If assessee avails Cenvat credit, duty payable will be - Basic - Rs 19.20 lakhs, Education Cess - Rs 38,400 and SAH education Cess - Rs 19,200.

Question : A small scale manufacturer had achieved sales of Rs. 73 lakhs in 2006-07. Turnover achieved during 2007-08 was Rs 1.52 crores. Normal duty payable on the product is 16% plus education cesses as applicable. Find the total excise duty paid by the manufacturer during 2007-08 (a) If the unit has availed Cenvat credit (b) If the unit has not availed Cenvat credit. [The turnover is without taxes and duties] [ICWA Inter December 2004 adopted].

Answer :

(a) If the unit has availed Cenvat credit, it has to pay full duty on entire turnover. Hence, duty payable is 16% of Rs 1.52 crores i.e. Rs 24.32 lakhs, plus education cess @ 2% of Rs 24.32 lakhs i.e. 48,640, plus SAH education cess @ 1% of Rs 24.32 lakhs i.e. Rs 24,320. Total – Rs 25,04,960.

(b) If the SSI unit has not availed Cenvat, the duty payable is as follows: (i) On first Rs. 150 lakhs : Nil (ii) On subsequent sales : Normal duty of 16% plus education cesses as appli-

cable. Thus, duty on remaining Rs 2 lakhs will be Rs 32,000. Thus, excise duty paid is Rs 32,000, plus education cess of Rs 640 plus SAH education cess of Rs 320 Total – Rs 32,960.

Question : An SSI manufacturer may like to pay full duty even when he is eligible for SSI exemption. (*a*) Can he do so ? (*b*) Why he would like to pay full duty ? (*c*) What is the duty payable ?

Answer : (*a*) Yes, he can do so. He can avail Cenvat on inputs. (*b*) He would like to do so if his customer wants to avail Cenvat and if duty paid on his inputs is high. In such case, effective cost of the buyer is reduced, if the manufacturer pays duty. (*c*) Duty payable will be normal rate, less concession available, if any, under any exemption notification.

Question : A small scale manufacturer produces a product 'P'. Some of the production bears his own brand name, while some production bears brand name of his customer. The customer purchases the goods from the small scale unit and sales himself by adding 20% margin over his purchase cost. Clearances of the SSI unit in 2006-07 was Rs. 3,53,00,000. He achieved clearances of Rs 445 lakhs in 2007-08 as per following break up. [These clearances are without considering excise duty and sales tax]

(*a*) Clearances with his own brand name : Rs. 80 lakhs.

(*b*) Clearances of product bearing his customer's brand name : Rs. 365 lakhs.

Normal excise duty of his product is 16% plus education cesses as applicable. The SSI unit intends to avail Cenvat benefit on inputs on goods supplied to the brand name owner but intends to avail SSI exemption on his own clearances.

(A) Find the total duty paid by the manufacturer in 2007-08, if (a) Inputs are common but SSI unit is able to maintain separate records of inputs in respect of final products under his brand name and those with other's brand name (b) The inputs are common and SSI unit is not able to maintain separate records on inputs used in final products manufactured under his brand name and with other's brand name.

(B) What will be the rate of excise duty payable by him in April 2008 (*a*) on product bearing his own brand name *and* (*b*) on product bearing his customer's brand name.

(C) Will there be any difference in duty payable in April 2008 if all his clearances of Rs. 445 lakhs in 2007-08 were of product under his own brand name ?

Answer : (*A*) SSI unit can avail Cenvat on final products cleared under other's brand name and avail SSI exemption in respect of his own production. (a) In the first case, he has to pay duty @ 16% on Rs 365 lakhs, i.e. Rs 58.40 lakhs plus education cess of Rs 1,16,800 plus SAH education cess of Rs 58,400. He cannot avail Cenvat credit in respect of inputs used to manufacture product under his own brand name. (b) In the second case, since he is unable to maintain separate record of inputs, he will have to pay 10% 'amount' on Rs 80 lakhs as per rule 6(3)(b) of Cenvat Credit Rules. Thus, he has to pay duty of Rs 58.40 lakhs, plus education cess of Rs 1,16,800 plus SAH education cess of Rs 58,000, plus an 'amount' of Rs 8.00 lakhs. He can avail Cenvat of all the inputs. - - Note that in respect of goods bearing customer's brand name, duty is payable on his selling price to the customer even if customer sells them subsequently at higher price.

The assessee has to carefully do his costing and decide (a) whether to avail Cenvat on all inputs, pay full duty on all final products and 10% 'amount' on final products cleared under his own brand name or (b) Not avail Cenvat at all and avail exemption from duty on his own production with his brand name.

(*B*) The turnover of SSI during 2007-08 was over Rs. 4 crores. However, for purposes of calculating the upper limit of Rs. 4 crores, clearances with other's brand name are not to be considered. Hence, from 1st April 2008, he can clear goods bearing his own brand name upto Rs 150 lakhs without payment of duty, if he does not avail Cenvat credit on inputs used in such products. If he is unable to maintain separate records, he will have to pay 10% 'amount' on goods manufactured under his own brand name.

(*C*) If total turnover of Rs. 4.45 crores in 2007-08 was under his own brand name, the manufacturer is not eligible for any Small industry concession in April 2006, and he will have to pay duty at normal rates on his total clearances in April 2008.

STUDY NOTE - 3

CENVAT CREDIT

This Study Note includes

- Background
- Overview of Cenvat Credit Rules, 2004

3.1 BACKGROUND

Excise and Service tax are central taxes, expected to be consumption based taxes to the extent practicable. Till the goods or service is finally consumed, the burden of excise duty and service tax is passed on to next buyer, who gets credit of the tax and excise duty paid by the supplier/ service provider. Thus, effectively, tax is paid on value added at each stage, as illustrated in following example.

	Transaction without VAT		**Transaction With VAT**	
Details	A	B	A	B
Purchases	-	110	-	100
Value Added	100	40	100	40
Sub–Total	100	150	100	140
Add Tax 10%	10	15	10	14
Total	110	165	110	154

'B' is purchasing goods from 'A'. In second case i.e. under Vat, his purchase price is Rs 100/- as he is entitled to Cenvat credit of Rs 10/- i.e. tax paid on purchases. His invoice shows tax paid as Rs 14. However, since he has got credit of Rs 10/-, effectively he is paying only Rs 4/- as tax, which is 10% of Rs 40/-, i.e. 10% of 'value added' by him.

Cenvat (Central Value Added Tax) scheme is used to achieve the aim of levying tax only on 'value added' at each stage.

Goods and Service Tax – It is envisaged to have uniform all India 'Goods and Service Tax' (GST) by 1-4-2010. As an important step toward that, credit of service tax and central excise duty has been made inter-changeable. Finance Minister Shri P Chidambaram, in para 148 of his budget speech on 8-7-2004, stated as follows, 'I propose to take a major step towards integrating the tax on goods and services. Accordingly, I propose to extend credit of service tax and excise duty on goods and services. Accordingly, I propose to extend credit of service tax and excise duty across goods and services'.

To give effect to this proposal, Cenvat Credit Rules, 2004 were issued and made effective from 10-9-2004.

3.1.1 Highlights of Cenvat Credit scheme

General highlights of the scheme are as follows :

Credit of duty paid on input and input services - The Cenvat scheme is principally based on system of granting credit of duty paid on inputs and input services. A manufacturer or service provider has to pay excise duty and service tax as per normal procedure on the basis of 'Assessable Value' (which is mainly based on selling price). However, he gets credit of duty paid on inputs and service tax paid on input services. Thus, he actually pays amount equal to duty / service tax as shown in invoice less the Cenvat credit available to him.

Input goods eligible for Cenvat to manufacturer - Credit will be available of excise duty paid on (*a*) raw materials *(excluding few items)* (*b*) material used in or in relation to manufacture like consumables etc. (*c*) Paints, packing materials, fuel etc. used for any purpose. The input may be used directly or indirectly in or in relation to manufacture. The input need not be present in the final product. Inputs need not be used within the factory. However, duty paid on high speed diesel oil (HSD), Light Diesel Oil (LDO) and motor spirit (petrol) is not available as Cenvat credit, *even if these are used as raw materials or as fuel.* [rule 2(k)(i) of Cenvat Credit Rules]

Inputs goods eligible for Cenvat to service provider - In case of service providers, only inputs used directly for providing output service are eligible for Cenvat credit. However, high speed diesel oil (HSD), Light Diesel Oil (LDO) and motor spirit (petrol) are not eligible as 'inputs'. [rule 2(k)(ii) of Cenvat Credit Rules]

As per notification No. 12 / 2003-ST dated 20-6-2003, a service provider is not required to pay service tax on goods and materials used by him for providing output services. Normally, service tax is not payable on goods where property is transferred to buyer. Hence, Cenvat credit will be available mainly in respect of consumables.

Inputs can be sent to job worker – Inputs can be sent to job worker for processing. These should be returned within 180 days [rule 4(5)(a)]. Final product can be cleared directly from premises of job worker on obtaining permission of AC / DC [rule 4(6) of Cenvat Credit Rules]

Wide definition of 'input service' – A manufacturer / service provider will be entitled to credit of service tax paid by him which are used by him directly or indirectly in or in relation to manufacture of final product / provision of output services. This would include even services which are received prior to commencement of manufacture / provision of output services. Even input services relating to setting up a factory will be eligible.

In addition to this, services like advertising, activities relating to business like accounting, auditing, storage, transport etc., which are not directly related to manufacture / provision of output services but are related to the sale of manufactured goods / provision of output services would also be permitted for credit. *In fact, all input services relating to all activities relating to business are eligible for Cenvat credit.* [rule 2(l) of Cenvat Credit Rules]

Services Billed/received at Head Office/Regional Offices - In some cases, the bill / invoice is raised in the name of head office / regional office etc., but services are actually received in the factory (or factories) or premises of service provider. In addition, the Head Office / Regional Offices receive services which are not specific for any factory / premises or service provider, such as advertising, market research, management consultancy etc. Bills in respect of such services would be received only in these offices. To enable the manufacturer / service provider to avail credit of such input services, a concept of "input service distributor" has been introduced [rule 2(m) of Cenvat Credit Rules]

The HO / Regional Office will have to register as 'Input Service Distributor' with Excise department. The HO / Regional Office will have to issue Invoice to the factory / office providing service. The factory / service provider can avail credit on basis of such invoice. It would be left to the assessee to decide as to how he distributes the credit among various factories or service providing units. He has to ensure that the total credit allowed does not exceed the eligible credit amount. Such offices which distribute the credit would have to obtain service tax registration [rule 7 of Cenvat Credit Rules].

Credit of duty paid on capital goods – Capital goods (machinery, plant, spare parts of machinery, tools, dies, etc.) as defined in rule 2(a), used for manufacture of final product and / or used for providing output taxable service will be available. Capital goods should be used in the factory. 50% credit is available in current year and balance in subsequent financial year or years [rule 4(2)(a) of Cenvat Credit Rules]. Assessee should not claim depreciation on duty portion on which he has availed Cenvat credit [rule 4(4) of Cenvat Credit Rules]. A service provider can take out capital goods from his premises, provided that he brings them back within 180 days. This period can be extended [[second *proviso* to Rule 3(5) of Cenvat Credit Rules].

Removal of used capital goods as scrap - If capital goods are cleared after use as scrap, an 'amount' equal to duty on scrap value of capital goods is payable [rule 4(5A)]. If capital goods are removed after use (not as scarp), an 'amount' equal to Cenvat credit taken on the capital goods, reduced by 2.5% for each quarter of a year or part thereof, from date of taking credit.

Credit on motor vehicles used to provide output service – Motor vehicles are not 'capital goods' for purpose of 'manufacture', but credit on motor vehicles would be allowed as 'capital goods' only to the service providers of courier, tour operator, rent-a-cab scheme operator, cargo handling agency, outdoor caterer, pandal and shamiana operator and goods transport agency [rule 2(a)(B) of Cenvat Credit Rules]. Motor vehicle will not be treated as 'capital goods' for manufacturers or other service providers.

Credit on basis of specified documents - Credit is to be availed only on the basis of specified documents as proof of payment of duty on inputs or tax on input services. These include Invoice of manufacturer or registered dealer, Bill of Entry, Supplementary Invoice etc. [rule 9(1) of Cenvat Credit Rules]. If there is any defect in duty paying document, specific permission of AC / DC is required [rule 9(2) of Cenvat Credit Rules]

Credit available instantly in case of inputs - Credit of duty on inputs can be taken up instantly, i.e. as soon as inputs reach the factory or premises of service provider [rule 4(1) of Cenvat Credit Rules].

Cenvat credit of capital goods in two stages - In case of capital goods, upto 50% credit is available in current year and balance in subsequent financial year [rule 4(2)(a) of Cenvat Credit Rules].

Cenvat credit of service tax only after bill amount plus service tax paid - In case of input services, credit is available only after the amount of Bill value with service tax is paid to the service provider [rule 4(7) of Cenvat Credit Rules].

Cenvat to manufacturer available only if there is 'manufacture' - Cenvat on inputs or input services is available only if the process is 'manufacture'. Otherwise, Cenvat is not available [rule 3(1) of Cenvat Credit Rules]. [In fact, in such cases, no duty is payable on the final product and question of Cenvat does not arise at all].

Utilisation of Cenvat Credit - All taxes and duties specified in rule 3(1) of Cenvat Credit Rules form a 'pool'. This credit can be utilised by manufacturer of excisable goods or provider of taxable service, for payment of any tax or duty as specified in rule 3(4) of Cenvat Credit Rules.

One-to-one correlation not required - Cenvat Credit Rules do not require input-output correlation to be established.

No input credit if final product/output service exempt from duty/ service tax - No credit is available if final product is exempt from duty or final service is exempt from service tax [rule 6(1) of Cenvat Credit Rules].

If a manufacturer manufactures more than one product, it may happen that some of the products are exempt from duty. Similarly, in case of service provider, some services may be taxable while some services may not be covered. In such cases, duty paid on inputs and service tax paid on input services used for manufacture of exempted products / services cannot be used for payment of duty or tax on other final products / services which are not exempt from duty / tax.

If the manufacturer / service provider uses common inputs and input services both for exempted as well as un-exempted goods / services, he should maintain separate records for inputs / input services used for manufacture of exempted final products and should not avail Cenvat on such inputs / input services [rule 6(2) of Cenvat Credit Rules].

Partial manufacture/provision of exempted products/services – Cenvat credit of inputs and input services is not available if final product / output service is exempt from excise duty / service tax. In case of manufacturer manufacturing both exempt and dutiable goods (or service provider providing taxable as well as exempt services), it may happen that same inputs / input services are used partly for manufacture of dutiable goods / taxable services and partly for exempted goods / services.

In such cases, the manufacturer / service provider has following three options (w.e.f. 1-4-2008)

(a) Maintain separate inventory and accounts of receipt and use of inputs and input services used for exempted goods / exempted output services – Rule 6(2) of Cenvat Credit Rules.

(b) Pay amount equal to 10% of value of exempted goods (if he is 'manufacturer) and / or 8% of value of exempted services (if he is service provider) if he does not maintain separate inventory and records, if he is a manufacturer – Rule 6(3)(i) w.e.f. 1-4-2008.

(c) Pay an 'amount' equal to proportionate Cenvat credit attributable to exempted final product / exempted output services – Rule 6(3)(ii) w.e.f. 1-4-2008.

Full credit in case of specified input services - In case of specified services such as construction, erection / commissioning / installation etc. credit would be disallowed only when they are used *exclusively* in relation to manufacture of exempted goods / services. Otherwise full credit would be allowed [rule 6(5) of Cenvat Credit Rules]

No cash Refund, except in case of export - In some cases, it may happen that duty paid on inputs and service tax paid on input services may be more than duty payable on final products. In such cases, though the Cenvat credit will be available to the manufacturer / service provider, he cannot use the same and the same will lapse. There is no provision for refund of the excess Cenvat credit. *However, the only exception is in case of exports where duty paid on input material or services used for exported goods is refundable.* [rule 5 of Cenvat Credit Rules].

Other exception is Tribunal can order refund when Cenvat credit could not be availed due to fault / wrong action of the department. Refund may also be granted if assessee could not utilise credit for some other reason.

Reversal of Cenvat if final product or output service subsequently exempt – Cenvat Credit is availed as soon as inputs are received. If subsequently the final product or output service is exempt, there might be some inputs lying in stock on date of exemption. Such inputs will then be used for manufacture of exempted final products. In such case, Cenvat credit on such inputs will have to be reversed or equivalent amount paid, if Cenvat credit was already utilised [rules 11(3) and 11(4) of Cenvat Credit Rules of Cenvat Credit Rules].

Cenvat credit is indefeasible - In *CCE* v. *Dai Ichi Karkaria Ltd.* 1999(112) ELT 353 = 1999 AIR SCW 3205 = (1999) 7 SCC 448 = AIR 1999 SC 3234 (SC 3 member bench), it was held that Cenvat credit validly taken is indefeasible. It was also observed that co-relation between final product and raw materials is not required in Cenvat scheme. - - However, Cenvat credit balance at the year end is not income of assessee – *CIT* v. *Indo Nippon Chemicals* (2003) 130 Taxman 179 = 155 ELT 452 = 261 ITR 275 (SC).

3.2 Overview of Cenvat Credit Rules, 2004

Rule No.	Brief Contents
Proviso to rule 1(2)	Provisions relating to availment and utilisation of credit of service tax shall not apply to State of J&K.
2(a)	**'Capital goods' means – (A) The following goods, namely:- (i) all goods falling under chapter 82, chapter 84, chapter 85, chapter 90, heading No. 6805, grinding wheels and the like, and parts thereof falling under heading 6804 of the First Schedule to Excise Tariff Act (ii) Pollution control equipment.(iii) Components, spares and accessories of the goods specified at (i) and (ii) above (iv) Moulds and dies, jigs and fixtures. (v) Refractories and refractory material. (vi) Tubes, pipes and fittings thereof and (vii) Storage Tank.** **Used – (1) in the factory of the manufacturer of the final products, but does not include any equipment or appliance used in an office; or (2) for providing output service** (B) motor vehicle registered in the name of provider of output service for providing taxable service as specified in sub-clauses (f), (n), (o), (zr), (zzp), (zzt) and (zzw) of clause (105) of section 65 of the Finance Act, 1994
2(d)	**'Exempted goods' means goods which are exempt from whole of duty of excise leviable thereon and includes goods which are chargeable to 'Nil' rate of duty.**
2(e)	"Exempted services" means taxable services which are exempt from the whole of the service tax leviable thereon, and includes services on which no service tax is leviable under section 66 of Finance Act.
2(h)	'Final Product' means excisable goods manufactured or produced from inputs, or using input service.
2(k)	"Input" means – (i) all goods, except light diesel oil, high speed diesel oil and motor spirit, commonly known as petrol, used in or in relation to the manufacture of final products whether directly or indirectly and whether contained in the final product or not ***and includes*** lubricating oils, greases, cutting oils, coolants, accessories of the final products cleared along with the final product, goods used as paint, or as packing material, or as fuel, or for generation of electricity or steam used in or in relation to manufacture of final products or for any other purpose, within the factory of production; (ii) all goods, except light diesel oil, high speed diesel oil, motor spirit, commonly known as petrol and motor vehicles, used for providing any output service. *Explanation 1*.- The light diesel oil, high speed diesel oil or motor spirit, commonly known as petrol, shall not be treated as an input for any purpose whatsoever. *Explanation 2*.- Input include goods used in the manufacture of capital goods which are further used in the factory of the manufacturer

2(l)	"Input service" means any service – (i) used by a provider of taxable service for providing an output service; or (ii) used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products *upto* the place of removal (The words were 'from the place of removal' upto 31-3-2008) ***and includes*** services used in relation to setting up, modernization, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage upto the place of removal, procurement of inputs, ***activities relating to business, such as*** accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry and security, inward transportation of inputs or capital goods and outward transportation upto the place of removal
2(n)	Job Work means processing or working upon of raw materials or semi-finished goods supplied to job worker, so as to complete a part or whole of the process resulting in the manufacture or finishing of an article or any operation which is essential for the aforesaid process.
2(p)	"Output service" means any taxable service provided by the provider of taxable service, to a customer, client, subscriber, policy holder or any other person, as the case may be, and the expressions 'provider' and 'provided' shall be construed accordingly.
3(1)	Cenvat Credit is a 'pool' consisting of following duties and taxes, paid on input or capital goods or input service – • Basic excise duty on indigenous inputs [Paid on goods specified in First Schedule to CETA]. Corresponding CVD on imported goods is allowable. • Education cess on manufactured excisable goods and CVD equal to education cess on imported goods. This credit can be utilised only for payment of education cess on final product or output services • SAH (Secondary and Higher Education) Cess manufactured excisable goods and CVD equal to SAH education cess on imported goods. This credit can be utilised only for payment of SAH education cess on final product or output services. • Service tax on input services paid u/s 66 of Finance Act. • Education cess paid on service tax. This credit can be utilised only for payment of education cess on final product or output services. • SAH Education cess paid on service tax. This credit can be utilised only for payment of SAH education cess on final product or output services. • Additional Customs Duty paid u/s 3(5) of Customs Tariff Act w.e.f. 1-3-2005 (SAD or Special CVD). This credit will not be available to service providers [This duty is perceived as in lieu of sales tax. It is payable @ 4%. on most of the products, with few exceptions.] • National Calamity Contingent Duty (NCCD) leviable under section 136 of Finance Act, 2001 and corresponding CVD paid on imported goods. This credit can be used for payment of NCCD on outputs only and not for any other duty. • Additional Excise Duty paid under section 85 of Finance Act, 2005. This duty is payable w.e.f. 1-3-2005 on pan masala and certain tobacco products, as specified in Seventh Schedule to Finance Act, 2005 [Credit of Additional Excise Duty paid under section 85 of Finance Act can be used for payment of this duty. Any other credit cannot be utilised and balance amount is required to be paid in cash only].

3(2)	Manufacturer can take Cenvat credit of goods in stock on day when the final product ceases to be exempted goods or becomes excisable.
3(4)	Pool of 'Cenvat Credit' [as defined in rule 3(1)] can be utilised for any of the following – • ***Any*** duty on *any* final product manufactured by manufacturer [Rule 3(4)(a)] • Payment of 'amount' if inputs are removed as such or after partial processing [Rule 3(4)(b)] • Payment of 'amount' on capital goods if they are removed as such [Rule 3(4)(c)] • Payment of 'amount', if goods are cleared after repairs under rule 16(2) of Central Excise Rules [Rule 3(4)(d)] • Service tax on output service [Rule 3(4)(e)] • Payment under Cenvat Credit Rule 6 of 10% 'amount' on exempted goods or reversal of credit on inputs when common inputs or common input services are used for exempted as well as dutiable final products – *Explanation I* to Cenvat Credit Rule 6(3) • Reversal of Cenvat credit, if assessee opts out of Cenvat – Rule 11(2) • Payment of 'amount' if goods sent for job work are not returned within 180 days – Rule 4(5)(a).
First proviso to rule 3(4)	Even if duty / tax is payable by 5th / 6th / 15th / 16th of following month, credit can be taken only as available on last day of the current month
Second proviso to rule 3(4)	Restrictions on some credits [summarised above under rule 3(1)]
3(5)	'Amount' equal to Cenvat credit availed to be paid if capital goods or inputs removed 'as such' from the factory.
First *proviso* to Rule 3(5)].	A service provider cannot avail Cenvat credit of special CVD of 4% paid u / s 3(5) of Customs tariff Act.
Second *proviso* to Rule 3(5)].	If capital goods are removed after use (but not as waste and scrap), an 'amount' equal to Cenvat credit taken on the capital goods, reduced by 2.5% for each quarter of a year or part thereof, from date of taking credit.
3(5A)	'Amount' equal to duty on scrap value payable if capital goods are cleared as waste and scrap. This 'amount' is eligible as Cenvat Credit, as per rule 3(6)
3(5B)	If (i) inputs or (ii) capital goods before being put to use, are written off in books or provision made in books, 'amount' to be paid equal to Cenvat availed
3(5C)	If duty on final products is remitted under rule 21 of Central Excise, Cenvat credit of duty paid on inputs used in manufacture or such goods shall be reversed.
3(6)	'Amount' paid under rule 3(5) and 3(5A) is eligible as Cenvat credit to the buyer
3(7)(a)	Cenvat credit of duty paid by EOU as per formula
3(7)(b)	NCCD, Education cess, SAH cess and additional duty under section 157 of FA 2003 or 85 of FA 2005 can be used for respective duties only. Education cess of excise and service tax inter-changeable. Similarly, SAH Education cess of excise

4(1)	Cenvat credit can be taken immediately on receipt of goods in factory or premises of service provider
4(2)	Capital goods – Cenvat Credit Upto 50% in first financial year and balance in subsequent years, if they are in possession of manufacturer.
4(3)	Cenvat credit available if capital goods taken on leas, hire or loan agreement
4(4)	Depreciation on capital goods should not be availed on the excise duty portion of value of capital goods
4(5)(a)	Inputs and capital goods can be sent to job worker and should be brought back in 180 days
4(5)(b)	Restriction of 180 days does not apply to tools, dies, jigs and fixtures can be sent to job worker
4(6)	Final product can be cleared directly from place of job worker on obtaining permission from AC / DC, valid for a financial year
4(7)	Credit of input services can be availed only after the output service provider makes payment of value of input services and the service tax payable on it, as shown in invoice of input service provider.
5	Refund if final product is exported.
5A	Refund in case of Exports by exempted units in North-East Region and Sikkim
6(1)	Cenvat credit is not admissible on such quantity of input or input service which is used in manufacture of exempted goods or exempted services, except as provided in rule 6(2)
6(2)	Manufacturer manufacturing both exempt and dutiable goods (or service provider providing taxable as well as exempt services), may maintain separate inventory and accounts of receipt and use of inputs and input services used for exempted goods / exempted output services. In such cases, he should not avail Cenvat credit of the inputs and input services which are used in exempted final services at all.
6(3)(i)	If the manufacturer / service provider opts not to maintain such separate accounts, he has to pay an amount equal to 10% of the value of such exempted goods / 8% of value of exempted services. Such payment can be made by debit to Cenvat credit account or PLA [*explanation* II to rule 6(3A) [amendment w.e.f. 1-4-2008. Earlier, in few cases as specified in rule 6(3)(a), the manufacturer had to reverse Cenvat credit. Earlier, a service provider of exempted and non-exempted services not maintaining separate accounts was eligible to utilise Cenvat credit only to the extent of 20% of service tax payable on output services, under erstwhile rule 6(3)(c) existing upto 31-3-2008]..
6(3)(ii)	Alternatively, the manufacturer / service provider can opt to pay an 'amount' which is proportional to Cenvat credit availed on exempted final product / exempted output services [amendment w.e.f. 1-4-2008]

Explanation I to Rule 6(3)	Such option [rule 6(3)(i) or rule 6(3)(ii)] has to be exercised in respect of all exempted goods manufactured and all exempted output services provided. The option once exercised shall not be changed in remaining part of financial year
6(3A)(a)	The assessee exercising option under rule 6(3)(ii) should inform prescribed details to Superintendent, while exercising the option.
6(3A)(b)	The manufacturer of goods or the provider of output service shall determine and pay, provisionally, for every month amount of Cenvat credit attributable to input services used in relation to manufacture of exempted product or provision of exempt services, on the basis of ratios of previous year
6(3A)(c)	At the year end, the manufacturer of goods or the provider of output service shall determine finally amount of Cenvat attributable to input services used in relation to manufacture of exempted product or provision of exempt services, on basis of finalised accounts.
6(3A)(d)	If amount is found to be short paid, the difference should be paid by 30 th June of succeeding year.
6(3A)(e)	In addition to the amount short-paid, the assessee will be liable to pay interest at the rate of twenty-four per cent per annum from the due date, i.e., 30th June till the date of payment, where the amount short-paid is not paid within the said due date.
6(3A)(f)	If at the year end, it is found that the amount provisionally paid was more than the amount finally determined, the manufacturer of goods or the provider of output service may adjust the excess amount on his own, by taking credit of such amount.
6(3A)(g)	The manufacturer of goods or the provider of output service shall intimate to the jurisdictional Superintendent of Central Excise, within a period of fifteen days from the date of payment or adjustment, the prescribed particulars.
6(3A)(h)	If assessee does not manufacture dutiable final products or taxable output service, he can take credit but is not required to pay proportionate amount on provisional basis as provided in rule 6(3A)(b). However, at year end, he should pay amount on proportionate before 30th June.
Explanation I to rule 6(3A)	"Value" for the purpose of rules 6(3) and 6(3A) shall have the same meaning assigned to it under section 67 of the Finance Act, 1994 read with rules made thereunder or, as the case may be, the value determined under section 4 or 4A of the Central Excise Act, 1944 read with rules made thereunder
Explanation II to rule 6(3A)	The amount under rule 6(3) or 6(3A) shall be paid by 5th of following month (except in March, where it is payable by 31st March).

6(4)	Capital goods used exclusively for manufacture of exempted goods or providing exempt service are not eligible for Cenvat credit.
6(5)	In case of 16 specified services, full Cenvat credit available even if service partly used for exempted goods or exempted service.
6(6)	If excisable goods are removed to SEZ, EOU, EHTP, STP, UN agencies or for exports or removal of gold or silver arising in manufacture of copper or zinc by smelting, rules 6(1) to 6(4) do not apply i.e. payment of 10% 'amount' or proportionate reversal is not required.
7	The 'Input Service Distributor' [as defined in rule 2(m)] may distribute Cenvat Credit in respect of service tax, among its manufacturing units or providing output service. The credit distributed should not be more than the service tax paid.
7A	The office of service provider where inputs were received can distribute the credit of duty paid on such inputs and capital goods to the service provider by issuing an invoice. Such office will have to be registered with Central Excise and submit returns etc. similar to first stage dealer and second stage dealer.
8	Inputs can be stored outside the factory, with permission of AC/DC
9(1)	Cenvat Credit can be taken on the basis of - • Invoice of manufacturer from factory • Invoice of manufacturer from his depot or premises of consignment agent • Invoice issued by registered importer • Invoice issued by importer from his premises or consignment registered with Central Excise • Invoice issued by registered first stage or second stage dealer • Supplementary Invoice by manufacturer • Bill of Entry • Certificate issued by an appraiser of customs in respect of goods imported through foreign post office • TR-6 or GAR-7 Challan of payment of tax where service tax is payable by other than input service provider • Invoice, bill or challan issued by provider of input service on or after 10-9-2004 • Invoice, Bill or Challan issued by input service provider under rule 4A of Service Tax Rules.

Proviso to rule 9(1)	**If a first stage or second stage dealer mentions in his invoice that Cenvat credit of the special CVD paid u/s 3(5) of Customs Tariff Act is not admissible, buyer cannot avail the Cenvat credit.**
9(2)	**Cenvat credit can be taken only if *all* the particulars as prescribed in Central Excise Rules, 2002 or Service Tax Rules, 1994 are contained in the eligible duty paying document. Otherwise, permission of AC/DC is required.**
9(4)	First stage dealer and second stage dealer to maintain proper records and pass on duty on '*pro rata*' basis.
9(5)	Manufacturer and provider of output service to maintain proper records. Burden of proof of admissibility of Cenvat credit is on him.
9(8)	First stage dealer and second stage dealer to submit quarterly return within 15 days from end of quarter.
9(10)	Input service distributor to submit half yearly return within one month
9(11)	Revised return of Cenvat credit by provider of output service within 60 days.
9A(1)	Information relating to Principal Inputs to be submitted annually by 30th April of each Financial Year by specified manufacturers other than SSI, in form ER-5. Change also to be informed within 15 days
9A(3)	Monthly return of receipts and consumption of Principal Inputs by specified manufacturers of excisable goods in form ER-6
10	Transfer of unutilised Cenvat credit, if a manufacturer shifts his factory or provider of output services shifts his business or a manufacturer / service provider transfers his factory / business on account of change in ownership or on account of sale, merger, amalgamation, lease or transfer of factory to a joint venture.
11(2)	Reversal of credit at the time of opting out by SSI unit by paying an 'amount' equivalent to Cenvat credit on such inputs lying in stock or inputs contained in final products. Balance Cenvat credit, if any, will lapse.
11(3)	If final product is exempt subsequent to receipt of inputs, Cenvat credit on inputs lying in stock as on date of such exemption to be reversed by payment of 'amount'.
12	Full credit available in case of goods obtained from North Eastern States, J&K, Sikkim and Kutch district, even if the manufacturer is exempt from duty
12A	Procedures applicable to LTU
14	Recovery of Cenvat wrongly availed with interest
15	Confiscation and penalty for contravention of provisions
15A	General penalty of Rs 5,000 for contravention of rules when no penalty is provided in rules.

STUDY NOTE - 4

ISSUES RELATING TO CENVAT

This Study Note includes

- Cenvat Credit
- Input Goods
- Cenvat Credit of Input Services
- Input Service Distributor
- Cenvat Credit of duty paid on Capital goods
- Utilisation of Cenvat Credit
- Reversal of Cenvat
- Practical Examples
- Documents for availing Cenvat Credit
- Exempted Goods / Output Services
- Removal of Input,Capital Goods and Waste
- Other Provisions of Cenvat
- Accounting Treatment of Inputs in Cenvat

4.1 CENVAT CREDIT

Cenvat credit available when one item in a combination pack is bought out - In *Lotte India* v. *CCE* (2008) 224 ELT 102 (CESTAT SMB), assessee was selling combination pack of coffee bite and butter scotch. Coffee bite was manufactured while butter scotch was bought out. Product was sold under MRP provisions. It was held that combi-pack is a manufactured product and assessee is eligible for credit of duty paid on butter scotch purchases - relying on *CCE* v. *Gupta Soaps* (2007) 213 ELT 372 (CESTAT).

In *CCE* v. *Gupta Soaps* (2007) 213 ELT 372 (CESTAT SMB), assessee was supplying soap along with soap dish in one pack. Duty was paid on basis of MRP printed on the soap. It was held that assessee can take Cenvat credit of duty paid on the soap dish.

Evaporation of final product - Loss due to natural causes in inputs as well as final products is permissible. In such case, it is not necessary to reverse Cenvat credit on inputs used in final product which are lost due to natural causes – *CCE* v. *Ajinkyatara SSK Ltd.* (2007) 210 ELT 223 (CESTAT SMB) * *CCE* v. *Shree Shiddheshwar SSK Ltd.* (2007) 209 ELT 150 (CESTAT SMB)

Reversal of Cenvat credit in respect of obsolete goods written off - As per rule 3(5B) of Cenvat Credit Rules (inserted w.e.f. 11-5-2007), if (i) inputs or (ii) capital goods before being put to use, are written of fully or provision is made in books of account to write off fully, the manufacturer is required to pay an 'amount' equal to Cenvat credit taken in respect of such inputs or capital goods. If these are subsequently used in manufacture of final products, manufacturer can take Cenvat credit of amount which was paid earlier.

4.2 INPUT GOODS

- Inputs which are used in or in relation to manufacture of taxable final product and inputs directly used for provision of taxable output service are eligible for Cenvat credit.

- Input may be used directly or indirectly in manufacture. Any input integrally connected with manufacturing process is eligible.
- Consumables are eligible. Process loss is eligible.
- Accessories, packing material and paints are eligible as inputs.
- Definition of 'input' is restricted for service providers. Only inputs used directly in providing service are eligible.
- If service provider charges separately for material supplied while providing service, its cost is not includible. Correspondingly, duty paid on such material is not Cenvatable.

4.3 CENVAT CREDIT OF INPUT SERVICE

Cenvat Credit is available on input goods, input services and capital goods.

- Cenvat credit is available of service tax paid on input services.
- Definition of 'input service' is very wide. Any service in relation to business is 'input service'.
- Credit of service tax on input services is available only after payment is made to service provider for service and also service tax.
- Service tax paid at Head Office, Regional/Branch office can be utilised through mechanism of 'Input Service Distributor'.

Manufacturer as well as service provider will be eligible to get Cenvat credit of 'input services'. Rule 2(l) of Cenvat Credit Rules reads as follows, w.e.f. 1-4-2008 –

Rule 2(l) - "Input service" means any service –

(i) used by a provider of taxable service for providing an output service; or

(ii) used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products, upto the place of removal; (The words 'from the place of removal' have been replaced by ', upto the place of removal' w.e.f. 1-4-2008).

and includes services used in relation to setting up, modernization, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage upto the place of removal, procurement of inputs, activities relating to business, such as accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry and security, inward transportation of inputs or capital goods and outward transportation upto the place of removal.

Wide coverage of input services – The words used in the definition in relation to manufacturer are 'in relation to'. 'In relation' expands the scope of coverage. It is not restrictive.

Service need not be received in factory or premises from where output service provided – In case of inputs and capital goods, Cenvat credit is eligible to manufacturer only if these are received in the factory. However, in case of input service, there is no such requirement. Input service need not be received in factory or premises of service provider.

In case of service provider, even there is no requirement that inputs and capital goods should be received in premises of service provider.

Input service should have relation to 'manufacture'?

Definition of 'input service' is very wide. Any service in relation to business is input service. So far, there was no resistance from industry for service tax, since they had a feeling that they will be able to avail Cenvat credit of service tax paid by them on all their input services.

However, in recent Tribunal decisions, a restrictive view is being taken that 'input service' should have relation with manufacture.

In *Colgate Palmolive P Ltd.* v. *CCE* (2008) 12 STT 269 = 7 STR 294 (CESTAT), a *prima facie* view was expressed that credit of input services which are common to manufactured as well as exempted / traded goods is not available. A *prima facie* view was also expressed that even services in the inclusive part of definition should be in relation to manufacture.

In *Coca Cola India* v. *CCE* (2007) 7 STR 529 (CESTAT), assessee was manufacturing concentrate for cold drinks. He was incurring expenditure for advertisement of aerated water and not concentrate. It was held that advertisement expenses is not his 'input service' since it is not related to manufacture of 'concentrate' but related to sale of aerated waters. The reason given was that such advertisement expenses are not includible in assessable value of base essence [Really, the issue is highly arguable. Aspect of valuation is independent of aspect of eligibility of Cenvat credit].

In *Gujarat Ambuja Cement Ltd.* v. *CCE* (2007) 8 STT 122 = 212 ELT 410 = 6 STR 249 (CESTAT). Hon. Tribunal in para 12 of the decision has observed, 'Crucial point to be noted in regard to Cenvat Credit is that credit availability is in regard to 'inputs'. The credit covers duty paid on input materials as well as tax paid on services, used in or in relation to the manufacture of the 'final product'. Therefore, extending the credit beyond the point of duty paid removal of the final product, would be contrary to the Scheme of Cenvat Credit Rules'.

In *Excel Crop Care* v. *CCE* (2007) 9 STT 249 = 7 STR 451 (CESTAT SMB), it was held that services of CHA (Customs House Agent) in relation to export is not in relation to manufacture and clearance and hence Cenvat credit is not eligible. Same *prima facie* view was held in *GHCL Ltd.* v. *CCE* (2007) 10 STT 254 (CESTAT).

Really, in case of exports, port is 'place of removal' since property in goods is passed on to buyer only when goods are handed over to shipping company. Hence, all expenses upto that place should be considered as 'input service'. In *Kuntal Granites* v. *CCE* (2007) 215 ELT 515

(CESTAT), it was held that in case of exports, customs port is the 'place of removal'. Hence, remission is to be granted if goods are destroyed by accident in transit before they are handed over in port for export.

In *Excel Crop Care* v. *CCE* (2007) 9 STT 249 = 7 STR 451 (CESTAT SMB), it was also held that construction services for setting up circles / gardens for putting sign boards is not in relation to advertisement of the product and is not eligible.

In *Rajhans Metals* v. *CCE* (2007) 8 STR 498 (CESTAT SMB), assessee availed Cenvat credit in respect of erection, commissioning and installation of windmills for generation of electricity. This was supplied to grid and corresponding quantum was withdrawn at the factory. It was held that electricity is not excisable and hence the services availed at windmill are not 'input services' – similar *prima facie* view in *India Cements* v. *CCE* (2008) 9 STR 65 (CESTAT SMB).

In *GHCL Ltd.* v. *CCE* (2007) 10 STT 254 (CESTAT), *prima facie* view was held that services received at residential colonies of staff do not qualify as 'input service' – similar *prima facie* view in *India Cements* v. *CCE* (2008) 9 STR 65 (CESTAT SMB).

These observations can and do mean that only input services relating to manufacture of final product or provision of output service are eligible for Cenvat credit. Hopefully, the matter will be set right soon either by large bench of Tribunal or Supreme Court.

Apart from the fact that definition of 'input service' is very wide, following factors need consideration –

- Whole purpose of Cenvat scheme is to avoid cascading effect. The interpretation should not be such as to defeat this basic purpose.
- The integration of Cenvat credit of excise duty and service tax is a pre-cursor to GST (Goods and Service Tax), where intention is to eliminate distinction between goods and services. The whole scheme of credit of 'input service' is designed from this point of view.
- It is well established that when two interpretations are possible, interpretation favouring assessee is to be preferred.
- The interpretation of definition of 'input service' should not lead to the situation where 'operation is successful but patient died'.

Coverage beyond manufacturing/service provision stage - Inclusive definition clause of rule 2(l) extends scope of 'input services' even beyond stage of 'manufacture' or 'provision of service'. The inclusive clause makes it clear that services much earlier to manufacture or provision of service or even after manufacture and after provision of service will be eligible as service tax credit.

Services which do not have even any casual relation with manufacture of goods or provision of service have been covered in the definition of 'input service'. In fact, any service in relation to business of assessee is 'input service'.

Thus, though the words used in rule 2(l)(ii) are 'used by the manufacturer, whether directly or

indirectly, in or in relation to the manufacture of final products and clearance of final products from the place of removal', in view of the words 'includes', the scope of definition is much wider than 'in or in relation to manufacture' and would cover even services unrelated to 'manufacture'. *This is also clear from the fact that service tax paid at Head Office and branches/depots can be utilised as Cenvat credit through the mechanism of 'input service distributor'.*

Services of commission agent – Commission Agents do promote sale and hence commission paid to them is eligible as 'input service' – *prima facie* view held in *Metro Shoes* v. *CCE* (2007) 10 STT 462 = 8 STR 502 (CESTAT).

Wide scope due to use of word 'includes' - The word used in *explanation* is 'includes'. As we have seen earlier, the word 'includes' denotes that scope is expanded, beyond normal meaning of term 'in relation to manufacture or clearance of final products' or 'in relation to providing an output service'.

Services relating to 'clearance' of final product – Services in or in relation to 'clearance of final products, *upto* place of removal' have been included in definition of 'input service' in respect of 'manufacturer' [The words were 'clearance of final product *from* the place of removal' upto 31-3-2008].

It is thus clear that service tax paid on all expenses of transport, insurance upto and in the depot or place of consignment agent will be eligible for Cenvat Credit. 'Storage upto place of removal' has specifically been defined as eligible input service in the inclusive clause of definition.

Clearance – This word has specific meaning in Central Excise, where 'clearance' means removal from the factory. Thus, expenses incurred for removal of final product from factory like loading final products in vehicles will get covered.

Place of removal – The words are not defined in Cenvat Credit Rules, but are defined in section 4(3)(c) of Central Excise Act as follows –

"Place of removal" means—

(i) a factory or any other place or premises of production or manufacture of the excisable goods;

(ii) a warehouse or any other place or premises wherein the excisable goods have been permitted to be deposited without payment of duty;

(iii) a depot, premises of a consignment agent or any other place or premises from where the excisable goods are to be sold after their clearance from the factory from where such goods are removed.

In *Mangalam Cement* v. *CCE* (2007) 8 STR 639 (CESTAT), strong *prima facie* view was held that if services relate upto the depot, service tax credit will be available.

Port/airport is place of removal in case of export - In case of exports, the place of removal is port where export documents are presented to customs office – *Kuntal Granites* v. *CCE* (2007)

215 ELT 515 = 2007 TIOL 930 (CESTAT) – quoted and followed in *Rajasthan Spinning & Weaving Mills* v. *CCE* (2007) 8 STR 575 (CESTAT). Hence, all expenses upto that place should be considered as 'input service'.

Activities relating to business

All services relating to business will be eligible for service tax credit. The words used are 'activities relating to business, such as - - - - - '. The activities specifically mentioned are as follows –

- Accounting, auditing, financing
- Recruitment and quality control
- Coaching and training
- Computer networking
- Credit rating
- Share registry
- Security
- Inward transportation of inputs or capital goods and
- Outward transportation upto the place of removal.

However, these are only illustrations, as the words used are 'such as'. The illustrations do not mean that only these services are covered under 'activities relating to business'. For example, the words used are 'outward transportation upto the place of removal'. It does not mean outward freight after place of removal is excluded.

Meaning of 'such as' - The words 'such as' are used only to illustrate the scope. It is not restrictive.

The input services relating to business can be used for any purpose whatsoever - As per inclusive definition of 'input service' [rule 2(l)], all services used for activities relating to business' are 'input services'. The definition does not say 'activities relating to business pertaining to manufacture or provision of output services'. Thus, all input services used in activities relating to business are 'input services', whatever may be its purpose.

Any expenditure incurred on ground of commercial expediency is for purpose of business – In *S A Builders Ltd.* v. *CIT (Appeals)* (2007) 158 Taxman 74 = 288 ITR 1 (SC), it was held that any expenditure incurred on ground of commercial expediency is allowable as business expenditure. 'For the purpose of business' is wider in scope than the expression 'for the purpose of earning income, profits or gains'. 'Commercial expediency' is an expression of wide import and includes such expenditure as a prudent businessman incurs for purpose of business. The expenditure may not have been incurred under legal obligation, yet it is allowable if it was incurred on grounds of commercial expediency – relying on *Madhav Prasad Jatin* v. *CIT* AIR 1979 SC 1291.

Mobile phones eligible for Cenvat Credit – Earlier Service Tax Rules required 'installation' of telephones in the business premises. Hence, CBE&C had clarified vide circular No. 59/8/2003-ST dated 20-6-2003 that Cenvat credit will not be available in case of mobile phones. Now there is no such requirement. Hence, service tax paid on mobile phones will be eligible for Cenvat credit w.e.f. 10-9-2004, so long as these are used for 'activity relating to business' – view confirmed in *Indian Rayon* v. *CCE* 2007 (6) STT 328 = 4 STR 79 (CESTAT SMB).

Internet services eligible – Cenvat credit is available in respect of internet services, as it is utilised for information relating to manufacture, sale and despatch – *Universal Cables Ltd.* v. *CCE* (2007) 7 STR 310 (CESTAT).

Outward freight after place of removal is not 'input service'?– One of the illustrations given in inclusive part of definition of 'activities relating to business' is 'outward freight upto place of removal'. Hence, a doubt is expressed that freight paid after place of removal is not 'input service'. This is not correct. As already explained, '*such as*' means what follows are only illustrations. These are not limitations. It does not mean outward freight after place of removal is excluded from definition of 'input service'. It should be eligible if it is in relation to activities of business.

In *CCE* v. *KTMS Engineering* (2007) 7 STR 274 (CESTAT), a *prima facie* view was expressed that service tax paid on outward freight from place of removal is eligible for Cenvat credit – same view in *Gujarat Sidhee Cement* v. *CCE* (2007) 7 STR 571 (CESTAT).

However, this view has not been accepted by Tribunal. In *Gujarat Ambuja Cement Ltd.* v. *CCE* (2007) 8 STT 122 = 212 ELT 410 = 6 STR 249 (CESTAT), it has been held that outward freight is not an input service. Service tax paid on the cost of transportation from the factory/depots to the buyers' premises, would not be available as credit – followed in *India Japan Lighting P Ltd.* v. *CCE* (2007) 11 STT 498 = 8 STR 124 = 218 ELT 103 (CESTAT) – same *prima facie* view in stay petition in *Ultratech Cement* v. *CCE* (2007) 8 STT 152 = 6 STR 364 (CESTAT).

Credit only after payment is made to service provider

Credit of input services can be availed only after the output service provider makes payment of value of input services and the service tax payable on it, as shown in invoice of input service provider. [Rule 4(7) of Cenvat Credit Rules]. [In case of excise duty, credit is available as soon as goods are received in the factory. There is no condition that credit can be availed only after payment is made to supplier of goods].

This peculiar provision has a specific purpose. The reason for this provision is that as per Service Tax Rules, the service tax is payable only after the amount is actually received by the service provider. Thus, the service provider of input services will be liable to pay service tax only when the person who has availed the service (output service provider in this case) pays the amount of his invoice.

It may happen that the output service provider may avail credit of service tax on input services on the basis of Invoice raised by provider of input services. However, he may not actually pay the amount of Invoice to the input service provider. If such thing happens, the service provider of output services will avail credit of service tax, while service provider of input services will

not be paying the service tax, as he has not received the payment. Hence, it is provided that service provider of output services can avail credit of service tax only when he makes payment of invoice of input service tax provider, including service tax charged by the input service tax provider.

Mere payment of service tax to service provider is not sufficient – Suppose the invoice is for Rs 100 and service tax is Rs 12.36, can you avail Cenvat credit if you pay only Rs 12.36 to the input service provider? The answer is no, as the words used are 'value of input services *and* the service tax payable on it'.

4.4 INPUT SERVICE DISTRIBUTOR

A manufacturer or service provider may have head office / regional office at different place / s. The services may be received at head office / regional office, but ultimately, these will be indirectly used for manufacture or providing output service. Provision has been made to avail Cenvat credit of services received and paid for at head office / regional office. Such head office / regional office can be registered with Central Excise as 'Input Service Distributor' and it can issue invoice on the manufacturer or producer or service provider.

Who is 'input service distributor' - As per rule 2(m) of Cenvat Credit Rules, "input service distributor" means (a) an office managing the business of manufacturer or producer of final products or provider of output service, (b) which receives invoices issued under rule 4A of the Service Tax Rules, 1994 towards purchases of input services ***and*** (c) issues invoice, bill or, as the case may be, challan for the purposes of distributing the credit of service tax paid on the said services to such manufacturer or producer or provider, as the case may be.

An office of assessee (manufacturer or service provider) is 'Input Service Distributor' if it satisfies all the three aforesaid requirements. It is not that each and every office of assessee is 'Input Service Distributor' and must register. The office should be registered as 'Input Service Distributor' only if it wants to distribute. There is no law that 'distribution' is the only way of availing Cenvat credit of services received at office of assessee. There are various documents eligible for availing Cenvat credit. Invoice / challan issued by 'Input Service Distributor' is only one of the specified document.

Document eligible for Cenvat credit - As per rule 9(1)(g); 'invoice, bill or challan' issued by an 'input service distributor' under rule 4A of Service Tax Credit Rules is an eligible document for purpose of taking Cenvat credit.

Concept of Input Service Distributor is a facility – not compulsion – Sometimes, an assessee has offices at various places but accounting is done centrally in the factory. Sometimes, there are various factories of assessee but accounting is done in main factory. In such cases, in my opinion, the main factory can directly take Cenvat credit of service tax on the basis of documents. The reason is that 'Input Service Distributor' is a facility. It is nowhere stated that the utilisation should be only through mechanism of Input Service Distributor. There is no law that 'distribution' is the only way of availing Cenvat credit of services received at office of assessee. A facility cannot be a compulsion.

Law does not even specify that there must be distribution of Cenvat credit or that the distribution should be in some specified ratio. If no 'distribution' is necessary, there should not be any need of 'Input Service Distributor'.

Distribution of credit by input service distributor – The 'Input Service Distributor' may distribute Cenvat Credit in respect of service tax, among its manufacturing units or providing output service. The credit distributed should not be more than the service tax paid. If an input service is attributable to service use in a unit exclusively engaged in manufacture of exempted goods or providing exempted services, the credit of such credit of service tax shall not be distributed [rule 7].

The 'input service distributor' should issue a 'Invoice, Bill or Challan' on monthly basis after consolidating the service tax paid on services received during the month.

4.5 CENVAT CREDIT OF DUTY PAID ON CAPITAL GOODS

- Only capital goods as defined in rule 2(a) of Cenvat Credit Rules are eligible for Cenvat Credit
- Capital goods should be used in the factory of manufacturer or for provision of output service
- Capital goods does not include equipment or appliance used in an office of manufacturer (this restriction does not apply to service provider)
- Motor vehicle is capital goods only in respect of specified service providers [rule 2(a)(B)]
- Capital goods should be used in factory. They can be sent outside for job work but should be brought back within 180 days [rule 4(5)(a)]
- Moulds, dies, jigs and fixtures can be sent outside [rule 4(5)(b)]
- Capital goods used exclusively for manufacture of exempted goods are not eligible for Cenvat credit
- Capital goods obtained on hire purchase/lease / loan are eligible [rule 4(3)]
- Duty paying documents eligible are same for Cenvat on inputs
- Depreciation under section 32 of Income Tax Act should not be claimed on the excise portion of the Capital Goods. – Rule 4(4) of Cenvat Credit Rules (Otherwise, the manufacturer will get double deduction for Income Tax - one credit as Cenvat and another credit as depreciation)
- Cenvat credit on capital goods is required to be availed in more than one year, viz. upto 50% credit can be availed when these are received and balance in any subsequent financial year. The condition for taking balance credit is that the capital goods should be in possession of manufacturer of final products in subsequent years. – Rule 4(2)(a) of Cenvat Credit Rules.

- If capital goods on which Cenvat was availed are removed as scrap, an 'amount' equal to duty on scrap value is payable [rule 3(5A)]. If capital goods are removed 'as such', an 'amount' equal to Cenvat credit availed on the capital goods is payable [rule 3(5)] If capital goods are cleared after use as second hand capital goods, 'amount' payable at reduced rate by reducing credit taken @ 2.5% per quarter.

Reversal of ***Cenvat credit if capital goods written off before use*** - As per rule 3(5B) of Cenvat Credit Rules (inserted w.e.f. 11-5-2007), if (i) inputs or (ii) capital goods before being put to use, are written of fully or provision is made in books of account to write off fully, the manufacturer is required to pay an 'amount' equal to Cenvat credit taken in respect of such inputs or capital goods. If these are subsequently used in manufacture of final products, manufacturer can take Cenvat credit of amount which was paid earlier.

Depreciation can be taken on 50% of Cenvat credit in first year? – In the first year, the assessee avails credit of only 50% of excise duty. The restriction in rule 4(4) regarding depreciation is only in respect of duty of which Cenvat credit has been taken. Hence, in *Suprajit Engineering Ltd*. v. *CCE* (2007) 6 STR 170 = 212 ELT 394 (CESTAT), it has been held that there is no violation of rule if assessee claims depreciation on the balance 50% of duty, since he has not availed credit of that amount in first year – followed in *Roots Cast* v. *CCE* (2007) 216 ELT 448 (CESTAT SMB).

Sending out of capital goods by service provider – Service provider can send out capital goods for providing output service. There is no requirement that these should be brought back within 180 days.

4.6 UTILISATION OF CENVAT CREDIT

- 'Cenvat Credit' is a pool of duties and taxes paid on inputs, capital goods and input services specified in rule 3(1) of Cenvat Credit Rules.
- The credit in this pool can be utilised for payment of any excide duty on excisable final product and service tax on taxable output service. The credit can also be used for payment of certain 'amounts'.
- Credit of various duties is inter-changeable, subject to few exceptions.
- Credit can be availed only of inputs and input services received upto end of the month.
- Cenvat credit will have to be reversed if the final product is subsequently exempt.

The basic conditions for taking Cenvat Credit are as follows –

- There should be 'manufacture' or provision of taxable output service
- Inputs (goods) should be used in or in relation to manufacture of final product or for provision of output service
- Input service should be utilised for manufacture of final product or provision of taxable output service

- Cenvat credit is available for duties and taxes specified in rule 3(1), paid on input, input services and capital goods, subject to restrictions as specified
- No credit is available if final product is exempt from duty or output service is not taxable
- Credit is available on the basis of specified documents only

The conditions for allowing Cenvat Credit, as specified in rule 4 are as follows –

- Cenvat credit on inputs is available as soon as inputs are received in the factory of manufacturer or premises of the provider of output service [rule 4(1)].
- Cenvat credit of capital goods can be taken upto 50% in the financial year in which capital goods are received and balance in subsequent year / s [rule 4(2)]
- Cenvat credit of capital goods is allowable even if the capital goods are acquired on lease, hire purchase or loan [rule 4(3)]. However, assessee should not claim depreciation on the excise portion of value of capital goods [rule 4(4)]
- Inputs and capital goods can be sent outside for job work but should be brought back within 180 days [rule 4(5)]
- Cenvat credit is available on jigs, fixtures, moulds and dies even if sent to job worker for production of goods on behalf of manufacturer [rule 4(6)]
- Cenvat credit of input service is allowed only after payment towards value of service and service tax is made [rule 4(7)]

Duties eligible for Cenvat credit - Assessee can avail credit of duty / service tax paid on inputs and input services. This credit is known as 'Cenvat Credit'. This is a 'pool' which is available for utilisation for payment of duty on any final product or output services, subject to certain restrictions and limitations.

Payment of NCCD on mobile phones can be only by Cenvat credit of NCCD and not any other Credit – As per fourth *proviso* to Cenvat Credit Rule 3(4) inserted w.e.f. 1-3-2008, only credit of NCCD can be utilised for payment of NCCD on mobile phones. Any other credit cannot be used. This restriction is only for mobile phones.

One to one correlation not necessary in Cenvat – Rule 3(4)(a) states that Cenvat credit may be utilised for payment of *any* duty of excise on *any* final product or service tax on output service. Thus, there is no requirement of establishing relation between inputs / input services and final product / output services. One to one relation is not required.

There is no correlation of the raw material and the final product; that is to say, it is not as if credit can be taken only on a final product that is manufactured out of the particular raw material to which the credit is related - *CCE* v. *Dai Ichi Karkaria Ltd.* 112 ELT 353 = AIR 1999 SC 3234 = 1999 AIR SCW 3205 = (1999) 7 SCC 448 (SC 3 member bench) – quoted with approval in *CCE* v. *Bombay Dyeing* (2007) 10 STT 286 (SC).

Full credit even if seller gave trade discount or price reduction later – Even if manufacturer-seller gave trade discount later, full credit of excise duty paid by him is available to buyer so

long as duty paid at supplier's end is not changed – *CCE* v. *Tirumala Fine Texturiser P Ltd.* (2007) 217 ELT 85 (CESTAT SMB) – same view in *Evergreen Engineering Co.* v. *CCE* (2007) 215 ELT 134 (CESTAT SMB) * *Brown Kraft Indus. Ltd.* v. *CCE* (2007) 212 ELT 369 (CESTAT) – same view in *Force Motors* v. *CCE* (2007) 213 ELT 302 (CESTAT), where it was held that credit available is of duty 'paid' and not duty 'payable'.

Restriction on Cenvat credit of goods supplied by EOU - From following data, determine the Cenvat allowable if the goods are produced or manufactured in a FTZ or by a 100% EOU and used in any other place in India. Assessable value : Rs. 770 per unit, Quantity cleared 1,000 units, BCD – 10%, CVD – 14%, plus education cess as applicable.

Answer - As per Rule 3(7)(a) of Cenvat Credit Rules, 2004 the following formula is to be used if a unit in DTA purchases goods from EOU, for clearances on or after 1-3-2006 - Assessable value x{[1+BCD / 400] X CVD / 100}

Hence, Cenvat Available per unit is as follows –

Cenvat	=	770 x {[1 + 10 / 400] x 14.42 / 100}
	=	770 x {1.025 x 0.1442}
	=	770 x 0.147805 = Rs 113.81 per unit

Total Cenvat allowable on 1,000 units = 1,000 x 113.81 = Rs. 1,13,81,000

4.7 REVERSAL OF CENVAT

Cenvat credit is taken as soon as inputs are received in factory or input services are paid for. In some cases, Cenvat credit may have to be reversed.

Reversal under rule 6 - If a manufacturer manufactures exempted as well as taxable goods and / or a service provider provides taxable as well as exempt services, he (manufacturer / service provider) is required to either pay 'amount' or reverse proportionate Cenvat credit. The issue is discussed in a later chapter.

Reversal if finished goods cleared at concessional rate of duty - Finished products can be sent under bond under Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 2001 without payment of duty. If such goods are sent, Cenvat credit will have to be reversed. If common inputs and input services were used on which Cenvat was availed, payment of 'amount' as per rule 6(3)(b) will be required. Case law discussed in another chapter.

Reversal if remission obtained on duty payable on final product - If final product is destroyed or becomes unfit for consumption, when the goods were in store room, duty on such final product can be remitted under rule 21 of Central Excise Rules. Rule 3(5C) of Cenvat Credit Rules (as inserted w.e.f. 7-9-2007) provides that if duty on final products is remitted under rule 21 of Central Excise, Cenvat credit of duty paid on inputs used in manufacture or such goods shall be reversed.

Reversal of Cenvat credit in respect of obsolete goods written off - As per rule 3(5B) of Cenvat Credit Rules (inserted w.e.f. 11-5-2007), if (i) inputs or (ii) capital goods before being put to use, are written of fully or provision is made in books of account to write off fully, the manufacturer is required to pay an 'amount' equal to Cenvat credit taken in respect of such inputs or capital goods. If these are subsequently used in manufacture of final products, manufacturer can take Cenvat credit of amount which was paid earlier.

Reversal if final product subsequently exempt – Cenvat Credit is taken as soon as goods enter factory premises. Final product may be cleared later. It may happen that the final product may be subsequently exempt (conditionally or unconditionally). At that time, some inputs (on which Cenvat has been availed) will be in stock. These inputs will be used for manufacture of exempted final product, if he decides to avail the exemption (in case of conditional exemption. In case of unconditional exemption, it is mandatory for him to avail exemption.

In such case, basic principle is that Cenvat is available only if duty is paid on final product. According to this principle, the Cenvat credit availed on stock is required to be reversed.

Rule 11(3) as inserted w.e.f. 1-3-2007 provides that in such case, the manufacturer will have to pay an amount equivalent to Cenvat credit availed by him in respect of inputs received for such final product and lying in stock or in process or contained in final product. Similar provision has been made in respect of services exempt subsequent to availment of Cenvat credit on inputs availed in rule 11(4).

Though the words used are 'pay such amount' in later para of rule 11(3)(ii) and in rule 11(4), it is stated that the said amount should be deducted from balance of Cenvat credit and balance will lapse. Thus, reasonable interpretation is that such amount should be first paid out of Cenvat credit available (if any) and balance should be paid through cash.

The rule makes provision only in respect of reversal of Cenvat credit on inputs and not in respect of input services and capital goods.

4.8 PRACTICAL EXAMPLES

Question – An assessee cleared various manufactured final products during June 2007. The duty payable for June 2007 on his final products was as follows – Basic – Rs 2,00,000 Education Cesses – As applicable. During the month, he received various inputs on which total duty paid by suppliers of inputs was as follows – Basic duty – Rs 50,000, Education Cess – Rs 1,000, SAH education Cess Rs 500. Excise duty paid on capital goods received during the month was as follows – Basic duty – Rs 12,000. Education Cess - Rs 240. SAH education cess - Rs 120. Service tax paid on input services was as follows – Service Tax – Rs 10,000. Education cess – Rs 200 SAH Education Cess - Rs 100. How much duty the assessee will be required to pay by GAR-7 challan for the month of June 2007, if assessee had no opening balance in his PLA account? What us last date for payment?

Answer – Education Cess payable on final products is Rs 4,000 (2% of Rs 2,00,000). SAH education cess payable is Rs 2,000.

The Cenvat credit available for June 2007 is as follows –

Description	Basic duty	Service Tax	Education Cess	SAH Education Cess
Inputs	50,000		1,000	500
Capital Goods (50% will be eligible and balance next year)	6,000		120	60
Input Service		10,000	200	100
Total	**56,000**	**10,000**	**1,320**	**660**

Credit of Rs 66,000 (56,000 + 10,000) can be utilised for basic duty Credit of education cess and SAH education cess can be utilised only for payment of education cess and SAH education cess on final product only.

Hence, duty payable through GAR-7 challan for June 2007 is as follows –

	Basic Duty Rs	Education Cess Rs	SAH Education Cess Rs
(A) Duty payable	2,00,000	4,000l	2,000
(b) Cenvat Credit	66,000	1,320	660
Net amount payable (A-B)	1,34,000	2,680	1,340

Last date for payment is 5th July, 2007.

Question - In aforesaid example, calculate duty payable by GAR-7 challan if assessee had following balance in his PLA account on 6-6-2007 (after debiting utilised amount for payment of duty for May 2007) - Basic duty - Rs 1,70,000, Service tax - Rs 30,000. Education Cess - Rs 4,000. SAH education Cess - Nil.

If credit was available on 1-6-2007, the total Cenvat credit available for June 2007 is as follows

Description	Basic duty Rs	Service Tax Rs	Education Cess Rs	SAH Education Cess Rs
Opening Balance	1,70,000	30,000	4,000	Nil
Inputs	50,000		1,000	500
Capital Goods (50% will be eligible and balance next year)	6,000		120	60
Input Service		10,000	200	100
Total	**2,26,000**	**40,000**	**5,320**	**660**

The duty payable will be as follows -

Hence, duty payable through GAR-7 challan for June 2007 is as follows –

	Basic Duty Rs	Education Cess Rs	SAH Education Cess Rs
(A)Duty payable	2,00,000	4,000l	2,000
(b) Cenvat Credit (basic plus service tax)	2,66,000	5,320	660
Net amount payable (A-B)	(-66,000)	(-1,120)	1,340

The credit of education cess of Rs 1,120 is to be carried forward since the credit cannot be utilised for payment of any other duty. Credit of basic duty can be utilised for payment of SAH education cess. Hence, the balance left in basic duty account will be Rs 64,660.

Thus, no excise duty is required to be paid for the month of June 2007. Balance carried forward will be as follows - (a) Basic duty - Rs 64,660 (b) Education Cess - Rs 1,120.

An assessee cleared his manufactured final products during January 2008. The duty payable for the month on his final products was as follows: Basic duty – Rs. 44,000, NCCD – Rs. 2,000, Education cesses – As applicable. During the month, he received various inputs on which total duty paid by suppliers of inputs was as follows - Basic duty – Rs. 40,000 plus applicable education cess. Service tax paid on input services was as follows: Service tax – Rs.

8,000. Education cess – Rs. 160. There is no opening balance in his PLA account. How much duty the assessee will be required to pay through account current for the month of January 2008? *(ICWA Inter June 2006 adopted)*

Education Cess payable on final products is Rs 920 (2% of Rs 46,000). SAH education cess payable on final products is Rs 460.

Education cess on his inputs is Rs 800 (2% of Rs 40,000)> SAH education cess on inputs is Rs 400. The Cenvat credit available for the month of January, 2008 is as follows –

Description	Basic duty	Service Tax	Education Cess	SAH Education Cess
Inputs	40,000		800	400
Input Service		8,000	160	80
Total	**40,000**	**8,000**	**960**	**480**

Credit of Rs 48,000 (40,000 + 8,000) can be utilised for payment of any duty.

Credit of education cess of Rs 960 can be utilised only for payment of education cess on final product.

Credit of SAH education cess of Rs 960 can be utilised only for payment of education cess on final product.

	Basic Duty Rs	NCCD	Education Cess Rs	SAH Education Cess Rs
(A)Duty payable	44,000	2,000	920	460
(b) Cenvat Credit (basic plus service tax)	48,000		960	480
Net amount payable (A-B)	(-4,000)		(-40)	(-20)

The credit of basic duty and service tax of Rs 4,000 can be utilised for payment of NCCD of Rs 2,000. Hence for the month of January, 2008, assessee is not required to pay any duty through PLA.

He will carry forward following balances for February 2008 - Basic duty - Rs 2,000. Education Cess - Rs 40. SAH education Cess - Rs 20.

Question – An assessee cleared his manufactured final products during July 2007. The duty payable for July 2007 on his final products was as follows – Basic – Rs 49,000. NCCD – Rs

1,000. Education Cess – As applicable. During the month, he received various inputs on which total duty paid by suppliers of inputs was as follows – Basic duty – Rs 40,000, Education Cess – Rs 800, SAH education Cess - Rs 400. Service tax paid on input services was as follows – Service Tax – Rs 8,000. Education cess – Rs 160, SAH education Cess - Rs 80. How much duty the assessee will be required to pay by GAR-7 challan for the month of July 2007, if there was no opening balance in his PLA account?

Kept for self study.

4.9 DOCUMENTS FOR AVAILING CENVAT CREDIT

Rule 9(1) of Cenvat Credit Rules prescribes that Cenvat Credit can be taken on the basis of -

- Invoice of manufacturer from factory
- Invoice of manufacturer from his depot or premises of consignment agent
- Invoice issued by registered importer
- Invoice issued by importer from his premises or consignment registered with Central Excise
- Invoice issued by registered first stage or second stage dealer
- Supplementary Invoice by manufacturer
- Bill of Entry
- Certificate issued by an appraiser of customs in respect of goods imported through foreign post office
- TR-6 or GAR-7 Challan of payment of tax where service tax is payable by other than input service provider
- Invoice, bill or challan issued by provider of input service on or after 10-9-2004
- Invoice, Bill or Challan issued by input service distributor under rule 4A of Service Tax Rules.

Credit in case of defects in duty paying document only with permission of AC/DC – Cenvat credit is available on basis of proof of duty paying document like Invoice or Bill of Entry. Sometimes, there are some minor defects in the duty paying document, which are technical in nature. However, fact of duty payment is not in doubt.

Rule 9(2) as amended w.e.f. 1-3-2007 provides that Cenvat credit can be taken only if ***all*** the particulars as prescribed in Central Excise Rules, 2002 or Service Tax Rules, 1994 are contained in the eligible duty paying document.

As per *proviso* to rule 9(2), if all prescribed details are not available in duty paying document, at least following minimum details should be available - (a) Details of duty or service tax payable

(b) description of goods or taxable service (c) assessable value (d) Central Excise or Service Tax Registration Number and (e) name and address of the factory or warehouse or premises of first or second stage dealers or provider of taxable service.

If all prescribed details are not available in duty paying document (but minimum details as prescribed above are available) and if Jurisdictional Assistant / Deputy Commissioner is satisfied that such goods or services covered by the document have been received and accounted for in books of account of receiver, he may allow Cenvat credit.

Thus, even if there is minor defect or omission in duty paying document, the assessee will have to make application to AC / DC and seek his permission to avail Cenvat credit

Provisions when dealer of imported goods is claiming refund of Special CVD of Customs – A dealer who imports goods and sales them in India after paying Vat / sales tax can claim refund of special CVD of 4% paid u / s 3(5) of Customs Tariff Act, as per Notification No. 102 / 2007-Cus dated 14-9-2007. If he intends to claim refund, he is required to make mention in his invoice to buyer that no credit of such additional duty shall be admissible (to buyer).

If a first stage or second stage dealer receives goods under an invoice which mentions that Cenvat credit of the special CVD paid u / s 3(5) of Customs Tariff Act is not admissible, he should make similar endorsement in his invoice to buyer. – *proviso* to rule 11(7) of Central Excise Rules. If such remark is there, the buyer cannot avail Cenvat credit of such special CVD *proviso* to rule 9(1) inserted w.e.f. 14-9-2007.

4.10 EXEMPTED GOODS/OUTPUT SERVICES

- Cenvat credit is available only if final product is dutiable.
- If assessee is manufacturing exempted as well as dutiable goods in same factory, he should maintain separate records.
- If common inputs / input services are utilised for exempted as well as taxable final product, assessee is required to pay 10% 'amount' on exempted final product.
- In case of services, his utilisation of credit is restricted to 20% of tax payable on taxable services.

Partial manufacture/provision of exempted products/services – Cenvat credit of inputs and input services is not available if final product / output service is exempt from excise duty / service tax. In case of manufacturer manufacturing both exempt and dutiable goods (or service provider providing taxable as well as exempt services), it may happen that same inputs / input services are used partly for manufacture of dutiable goods / taxable services and partly for exempted goods / services.

In such cases, the manufacturer / service provider has following three options (w.e.f. 1-4-2008) –

(a) Maintain separate inventory and accounts of receipt and use of inputs and input services used for exempted goods / exempted output services – Rule 6(2) of Cenvat Credit Rules.

(b) Pay amount equal to 10% of value of exempted goods (if he is 'manufacturer) and / or 8% of value of exempted services (if he is service provider) if he does not maintain separate inventory and records – Rule 6(3)(i) w.e.f. 1-4-2008.

(c) Pay an 'amount' equal to proportionate Cenvat credit attributable to exempted final product / exempted output services – Rule 6(3)(ii) w.e.f. 1-4-2008.

Cenvat credit on capital goods – If capital goods are partly used for exempted goods and party for dutiable final products, entire Cenvat credit of duty paid on capital goods is available. Cenvat credit of duty on capital goods is not allowable only when it is *exclusively* used for manufacture of final products [rule 6(4)]

No reversal or payment of amount in certain cases – If excisable goods are removed to SEZ, EOU, EHTP, STP, UN agencies or for exports or removal of gold or silver arising in manufacture of copper or zinc by smelting, payment of 10% 'amount' is not required [rule 6(6)].

Cenvat credit of service tax in case of supplies made by DTA to EOU - Supplies from DTA to EOU are entitled to Cenvat credit of service tax paid – para 6.11(v) of FTP.

4.10.1 Options available to manufacturer manufacturing both dutiable and exempt goods and service provider providing taxable as well as exempt services

The manufacturer / service provider has three options –

Maintain separate inventory and accounts - Maintain separate inventory and accounts of receipt and use of inputs and input services used for exempted goods / exempted output services. In such cases, he should not avail Cenvat credit of the inputs and input services which are used in exempted final services at all – Rule 6(2) of Cenvat Credit Rules.

Pay 10% 'amount' on value of exempted goods or 8% 'amount' on value of exempted services if separate inventory and records not maintained - If the manufacturer / service provider opts not to maintain such separate accounts, he has to pay an amount equal to 10% of the 'value' of such exempted goods or 8% of the value of 'exempted services' [Rule 6(3)(i) w.e.f. 1-4-2008 (Such payment can be made by debit to Cenvat credit account or PLA [*explanation* II to rule 6(3A)].

He cannot utilise Cenvat credit of inputs / input services utilised exclusively for manufacture or exempted final product or exempted output services, as is clarified in Explanation II to rule 6(3) inserted w.e.f. 1-4-2008.

Thus, he cannot utilise Cenvat credit in respect of inputs / input services utilised exclusively for manufacture of exempted final products or exempted taxable services. In addition, he has to pay 10% / 8% amount. Thus, the option of payment of 10% / 8% amount is not likely to be very attractive in most of the cases.

Such option has to be exercised in respect of all exempted goods manufactured and all exempted output services provided. The option once exercised shall not be changed in remaining part of financial year – *Explanation* I to Rule 6(3) inserted w.e.f. 1-4-2008.

Education cess and SAH education cess is payable only on 'duties of excise'. 'Amount' is not 'duty'. Hence, education cess or SAH education cess is not payable on such 'amount'.

Pay proportionate amount attributable to Cenvat credit utilised for exempted final product/ exempted output services – The manufacturer/service provider can opt to pay an 'amount' which is proportional to Cenvat credit availed on exempted final product/exempted output services [rule 6(3)(ii) w.e.f. 1-4-2008]

He cannot utilise Cenvat credit of inputs/input services utilised exclusively for manufacture or exempted final product or exempted output services, as is clarified in Explanation II to rule 6(3) inserted w.e.f. 1-4-2008.

Thus, he cannot utilise Cenvat credit in respect of inputs/input services utilised exclusively for manufacture of exempted final products or exempted taxable services. In addition, he has to pay proportionate amount relating to exempted final products/exempted output services.

This option seems to be much better than payment of 8%/10%.

If he wants to exercise this option, he has to inform details as prescribed in rule 6(3A) of Cenvat Credit Rules to Superintendent of Central Excise.

Such option has to be exercised in respect of all exempted goods manufactured and all exempted output services provided. The option once exercised shall not be changed in remaining part of financial year – *Explanation* I to Rule 6(3) inserted w.e.f. 1-4-2008.

Education cess and SAH education cess is payable only on 'duties of excise'. 'Amount' is not 'duty'. Hence, education cess or SAH education cess is not payable on such 'amount'.

4.10.2 Determination of Cenvat credit attributable to exempted final product/exempted services

If assessee intends to pay amount on proportionate basis, the 'amount' is to be calculated as provided in rule 6(3A) of Cenvat Credit Rules. He has to pay 'amount' provisionally on monthly basis. At the yearend, he has to calculate exact amount and pay difference if any or adjust excess amount paid.

Principle behind the calculations – The mode of calculation is as follows –

Assessee should first take entire Cenvat credit of inputs and input services used in exempted as well as taxable final products and exempted as well as taxable services. Then, at the end of month, he should calculate Cenvat credit attributable to exempted final products and exempted services on provisional basis, as follows –

Inputs used for exempted final products (Based on his own Input/Output ratio, even in case of common inputs like consumables etc.) + Inputs used for exempted services (On proportionate basis, based on ratio of previous year) + Input services used for exempted final products and exempted services (On proportionate basis based on ratio of previous year).

This amount should be reversed after end of each month.

At end of the year, assessee should calculate the ratios on actual basis and make fresh calculations and pay difference, if any, before 30th June. If it is found that he had paid excess amount based on provisional ratio, he can adjust the difference himself by taking credit.

In the first year of production or provision of services, ratios of previous year are not available. In that case, the calculations need not be made for the whole year. However, calculations should be made after the year is over and amount attributable to Cenvat credit on exempted final products and exempted services should be calculated and paid.

The basic idea behind the mode of calculations is sound and correct as per Vat principles. However, calculations are not easy and are prone to litigation.

There is no provision to calculate input services used exclusively for exempted services. This has to be done on ratio basis only.

Payment of 'amount' when intermediate product captively consumed in manufacture of another final product – In *CCE* v. *Texmo Industries* (2007) 213 ELT 615 (CESTAT), assessee used common inputs to manufacture rough castings. Some castings were sold while about 20% castings were captively consumed for manufacture of pumps. The pumps were also exempt from duty. It was held that 10% 'amount' is payable on value of castings and not on value of pumps. 'Casting' is the 'final product' and not 'pumps' – same view in *Texmo Industries* v. *CCE* (2007) 208 ELT 338 (CESTAT 3 member bench).

4.11 REMOVAL OF INPUT, CAPITAL GOODS AND WASTE

- Inputs and capital goods on which Cenvat credit was taken can be removed 'as such' on payment of 'amount' equal to Cenvat credit availed.
- If capital goods are sold as scrap after use, an 'amount' equal to duty on scrap value is payable.
- Inputs on which Cenvat was availed can be sent outside for job work. These should come back within 180 days.
- Direct despatch from place of job worker can be done with permission.
- Waste is final product for excise purposes and duty is payable as if final product is being cleared.
- If a particular waste is not mentioned in Central Excise tariff, neither any amount nor duty is payable at the time of clearance.

Removal of capital goods after use

Provisions of rule 3(5) apply when inputs or capital goods are removed 'as such'. Rule 2(a)(A) of Cenvat Credit Rules states that capital goods should be 'used'. Duration is not specified. Hence, even if the capital goods are used for one day, Cenvat eligibility of capital goods is established. After use, the capital goods can be removed either as scrap or as second hand capital goods.

Removal of capital goods as waste and scrap – *As per rule 3(5A) (inserted w.e.f. 16-5-2005), if capital goods are removed as scrap, the manufacturer shall pay an 'amount' equal to duty payable on transaction value. In other words, an 'amount' equal to duty on scrap value should be paid. It should be*

shown as 'amount' in the invoice and not 'duty'. Rule 3(6) makes it clear that the buyer can avail Cenvat credit of the 'amount'.

Removal of capital goods as second hand goods – *It is not that manufacturer will remove old capital goods only as scrap. He can as well sell it as second hand capital goods, if he does not need them. The machinery may be in working condition or could be brought in working condition after some expenditure.*

*In such case, if capital goods are removed after use, the manufacturer or output service provider shall pay an 'amount' (not 'excise duty') equal to Cenvat credit taken on the said capital goods, reduced by 2.5% for each quarter of a year or part thereof from the date of taking the Cenvat credit [*second proviso *to rule 3(5) of Cenvat Credit Rules, inserted w.e.f. 13-11-2007].*

For example, if capital goods are received in July 2007 (duty paid Rs 1,00,000), 50% i.e. Rs 50,000 credit was taken in November 2007, balance 50% credit was taken in April 2008, capital goods were installed in January 2008 and were sold after use in July 2009, the 'quarters' involved are 8 (2007 – 1, 2008-4, 2009 – 3) for first 50% and 6 for balance 50%.

Thus, assessee can get deduction of 20% of first Rs 50,000 (Rs 10,000) and 15% of balance Rs 50,000 (Rs 7,500). He has to pay 'amount' of Rs 82,500 (1,00,000 – 10,000 – 7,500).

The buyer can avail Cenvat credit of this 'amount' as made clear in rule 3(6) of Cenvat Credit Rules. Hence, seller should clear the second hand capital goods under 'invoice' charging 'amount' in invoice (not excise duty).

H Ltd. purchased a Boring-Drilling machine at a cum-duty price of Rs. 32,14,476. The Excise duty rate charged on the said machine was @ 16% plus education cess of 2% plus SAH education cess of 1%. The machine was purchased on 01.04.2007 and disposed of on 30.09.2008 for a price of Rs. 12 lakhs in working condition as second hand machinery. The company was claiming depreciation @ 25% following Straight Line Method. Using the said information, answer the following questions: (i) What is the Excise duty paid on the machine? (ii) What is the Cenvat credit allowable under Cenvat Rules? (iii) What is the amount of Cenvat credit reversible or duty payable at the time of clearance of the said machinery?.

Cum-duty price Rs. 32,14,476. Hence, Basic Price i.e. Assessable value = 32,14,476 * 100 / 116.48 = Rs. 27,59,680.63.

Total duty paid - 4,54,795.37

As per Cenvat Credit Rules, 50% Cenvat credit can be availed in current financial year and balance 50% of Cenvat is allowable only in following financial year, if the capital Goods are in possession and use. Hence, 50% Cenvat credit can be taken on 1-4-2007. Since the Capital goods were in use for six months in the year 2007-08, Cenvat of balance 50% is allowable on 1-4-2008.

As per second proviso to rule 3(5) of Cenvat Credit Rules, if capital goods are removed after use, the manufacturer or output service provider shall pay an 'amount' (not 'excise duty') equal to Cenvat credit taken on the said capital goods, reduced by 2.5% for each quarter of a year or part thereof from the date of taking the Cenvat credit. It is assumed that assessee took

credit on 1-4-2007. Since machinery was disposed of on 30-9-2008, reduction for 6 quarters @ 2.5% per quarter i.e. 15% will be available. Thus, assessee is required to pay 'amount' equal to 85% of Rs 4,54,795.37 i.e. Rs 3,86,576.06.

4.12 OTHER PROVISIONS OF CENVAT

Refund of service tax paid in respect of certain services utilised for exports – A manufacturer exporter can avail Cenvat credit of certain input services utilized in relation to export. However, according to Government press release dated 6-10-2007 – 10 STT 25 (St), press note dated 17-9-2007 – 10 STT 14 (St), press release dated 29-11-2007 – 11 STT 55 (St), some services utilised for exports do not fall within the definition of input services [In my view, they do fall within the definition of 'input service' for a manufacturer. The reason is that exports are invariably on FOB basis and hence port is the 'place of removal'. Another reason is the wide definition of 'input service']. Similarly, a merchant exporter utilises various input services for export of goods which he cannot avail any Cenvat credit. In respect of following such services, an exporter can claim refund of service tax paid on such services, under Notification No. 41/2007-ST dated 6-10-2007.

These services are – (a) General Insurance Services (b) Technical testing and analysis (c) Technical inspection and certification (d) Port and other port (e) Transport of export goods by road or by rail (f) Cleaning activity (g) Storage and warehousing (h) Courier services (i) Transport of goods by road from place of removal (j) Transport of goods by container from place of removal (k) CHA service (l) Banking and financial services (m) Services of commission agent.

(No refund is available in respect of other input services utilised for export)

Transfer of credit of duty paid on material lying at place of job worker permissible - **I**n *CCE* v. *Vaishali India* (2008) 224 ELT 247 (CESTAT SMB), assessee was shifting factory to new premises and sought permission for transfer of credit of duty paid on inputs lying at the premises of job worker. It was held that such credit cannot be denied.

Cash Refund if Cenvat cannot be utilised by exporter - If the credit cannot be used for payment of duty on any other final goods or service tax on other services, manufacturer or service provider can get cash refund of the same, if final products or output services were exported without payment of duty (either under bond or after giving Letter of undertaking), or if these were used in the intermediate product cleared for export. Refund is not admissible if exporter has availed duty drawback or has claimed rebate of duty in respect of such duties or has claimed rebate of service tax under Export of Service Rules - Rule 5 of Cenvat Credit Rules.

This provision is only for physical exports and not for deemed exports or home clearances.

The rule 5 states that no drawback should be claimed. Actually, duty drawback of customs portion should be allowable, since refund of Cenvat credit is only in respect of excise portion of duty drawback. Unfortunately, the way rule 5 is worded, this does not seem possible.

Para 2.48.1 of Foreign Trade Policy (as amended w.e.f. 7-4-2006), reads as follows, 'For all goods and services which are exported from units in DTA (Domestic Tariff Area) and units in EOU/EHTP/STP/BTP, remission of service tax shall be allowed'.

Para 6.11(c)(v) of Foreign Trade Policy (as amended w.e.f. 7-4-2006) states that EOU / EHTP / STP / BTP units shall be entitled to Cenvat Credit of service tax paid.

Rule 5 of Cenvat Credit Rules has been amended w.e.f. 14-3-2006 to provide for refund of Cenvat credit when final products or output service is exported.

Procedure for claiming refund of service tax paid on input services and excise duty on inputs has been specified in notification No. 5 / 2006-CE(NT) dated 14-3-2006.

Penalty for violation of Cenvat Credit Rules – Penalty upto Rs 5,000 can be imposed for violation of Cenvat Credit Rules [rule 15A of Cenvat Credit Rules inserted w.e.f. 1-3-2008].

4.13 ACCOUNTING TREATMENT OF INPUTS IN CENVAT

Accounting for Cenvat in books of account of assessee needs following considerations

(a) Since credit is available of excise duty / service tax paid while obtaining inputs / input services, duty / service tax paid on inputs while purchase is not an expense but an asset.

(b) Unavailed Cenvat is not available as refund (except when it is a case of exports). This may happen when duty / service tax paid on inputs is more than duty payable on final product.

(c) Cenvat is available instantly on receipt of inputs / payment of input service and Cenvat credit may be utilised even before inputs / input services on which Cenvat is availed are actually used in production.

(d) Rule 4(4) of Cenvat Credit Rules provides that depreciation should not be claimed on Cenvat credit availed.

(e) Credit on inputs and capital goods can be taken as soon as goods are received in the factory.

(f) In case of service tax, credit can be availed only after payment of Bill is made to the person who had provided input service.

(g) Credit of education Cess and NCCD can be utilised for payment of education Cess and NCCD only.

(h) Valuation of stock of inputs, WIP and finished goods also needs consideration.

Conflict between AS-2 and section 145A - As per section 145A of Income Tax Act, stock valuation should be inclusive of any tax, duty, cess or fee actually paid by assessee to bring the goods to the place of its location and condition as on date of valuation, even if such tax or duty is refundable. Thus, duty paid on inputs will have to be added while valuing stock, even if Cenvat credit is availed of such duty paid. In respect of finished stock, excise duty payable should be added to the inventory valuation even if not paid as goods are still lying in the factory. Both opening as well as closing stock should be valued on same basis.

However, as per Accounting Standard of ICAI (AS-2), inventory cost should comprise of all cost of purchases, cost of conversion and other costs incurred in bringing the inventories to the

present location and condition. Cost of purchase consists of purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to such acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase. Cost of purchases should be exclusive of duties which are recoverable from the taxing authorities. (e.g. Cenvat). Inventory should be valued at lower of cost or net realisable value. Inventory should be valued on FIFO (First in First Out) method or weighted average method. [LIFO is not permitted].

If Cenvat credit of duty paid on inputs is not available for any reason, the closing stock should be valued inclusive of duty paid on inputs. [Guidance Note of ICAI on Accounting Treatment of Modvat / Cenvat - September 2000 issue of Chartered Accountant].

Thus, for purposes of Income Tax, inventory is required to be valued inclusive of excise duty, even if assessee is entitled to get Cenvat credit of duty. However, for purposes of balance sheet as per Companies Act, inventory should be valued exclusive of excise duty, if assessee is entitled to get Cenvat credit of duty paid on inputs.

STUDY NOTE - 5

OVERVIEW OF CUSTOMS LAW

This Study Note includes

- Introduction
- Type of Custom Duties
- Valuation in Customs
- Procedures for Import
- Export Procedures
- Baggage,Courier and Import through Post
- Other Provisions in Customs

5.1 INTRODUCTION

- **Customs duty is on imports into India and export out of India. Section 12 of Customs Act, often called *charging section,* provides that duties of customs shall be levied at such rates as may be specified under 'The Customs Tariff Act, 1975', or any other law for the time being in force,** *on goods imported into, or exported from, India***.**
- There are many common provisions in Central Excise and customs Law
- In case of imports, taxable event occurs when goods mix with landmass of India - *Kiran Spinning Mills* v. *CC* 1999(113) ELT 753 = AIR 2000 SC 3448 = 2000 AIR SCW 2090 (SC 3 member bench).
- In case of warehoused goods, the goods continue to be in customs bond. Hence, 'import' takes place only when goods are cleared from the warehouse - confirmed in *UOI* v. *Apar P Ltd.* 1999 AIR SCW 2676 = 112 ELT 3 = 1999(6) SCC 118 = AIR 1999 SC 2515 (SC 3 member bench).- followed in *Kiran Spinning Mills* v. *CC* 1999(113) ELT 753 = AIR 2000 SC 3448 = 2000 AIR SCW 2090 (SC 3 member bench).
- In case of exports, taxable event occurs when goods cross territorial waters of India - *UOI* v. *Rajindra Dyeing and Printing Mills* 2005 (180) ELT 433 (SC)
- Territorial waters of India extend upto 12 nautical miles inside sea from baseline on coast of India and include any bay, gulf, harbour, creek or tidal river. (1 nautical mile = 1.1515 miles = 1.853 Kms). Sovereignty of India extends to the territorial waters and to the seabed and subsoil underlying and the air space over the waters.
- Indian Customs waters extend upto 12 nautical miles beyond territorial waters. Powers of customs officers extend upto 12 nautical miles beyond territorial waters.
- '*Exclusive economic zone*' extends to 200 nautical miles from the base-line.

5.1.1 Common aspects of Customs and Central Excise

There are many common links between Customs and Central Excise.

- Both are Central Acts and derive power of levy from list I - Union List - of the Seventh Schedule to Constitution.
- Both are under administrative control of one Board (Central Board of Excise and Customs) under Ministry of Finance.
- Organizational hierarchy is same from top upto Assistant Commissioner level. Transfers from customs to excise and *vice versa* are not uncommon.
- Chief Commissioner in charge of each Zone is same for excise and customs at many places.
- In the interior areas, Excise officers also work as customs officers.
- Classification Tariffs of both acts are based on HSN and principles of classification are identical.
- Principles of deciding 'Assessable Value' have some similarities i.e. both are principally based on 'transaction value'. Concept of 'related person' appears in Customs as well as Excise valuation.
- Provisions of refund, including principle of 'unjust enrichment' are similar. Provisions for interest for delayed payment are also identical.
- Provisions of raising demand for short levy, non-levy or erroneous refund are similar. Provisions in respect of recovery, mandatory penalty etc. are also similar.
- Provisions for granting exemptions from duty - partial or full - conditional or unconditional are identical.
- Powers of search, confiscation etc. are quite similar in many respects. In fact, some of provisions of Customs Act have been made applicable to Central Excise with suitable modifications.
- Provisions in respect of Settlement Commission and Authority for Advance Ruling are identical.
- Appeal provisions are identical.

- Appellate Tribunal (CESTAT) is same. Hence, procedures of appeal to Tribunal are identical.

5.2 TYPE OF CUSTOM DUTIES

- Basic customs duty levied u/s 12 of Customs Act.
- The rate of basic customs duty is specified in Customs Tariff Act, read with relevant exemption notification. Generally, basic customs duty is 10% of non-agricultural goods.
- CVD equal to excise duty is payable on imported goods u/s 3(1) of Customs Tariff Act. General excise duty rate is 16.48% (16% basic plus 2% education cess and SAH Education cess of 1%)
- Special CVD (SAD) is payable @ 4% on imported goods u/s 3(5) of Customs Tariff Act. This is in lieu of Vat/sales tax to provide level playing field to Indian goods.
- Education cess of customs @ 2% and SAH Education cess of 1% is payable.
- Total import duty considering all duties plus education cess on non-agricultural goods is generally 34.13%.
- NCCD has been imposed on a few articles. In addition, on certain goods, anti-dumping duty, safeguard duty, protective duty etc. can be imposed.

Total duty payable generally comes to 31.70% - It is said that the intention is to bring it down to 'Asian' level of 8%. It is not clear what is meant by 'Asian' level of 8%, but factually, the total customs duty payable is much higher i.e. 31.70% as given below.

Assessable value = CIF Value of imported goods converted into Rupees at exchange rate specified in notification issued by CBE&C plus landing charges 1%.

Calculation of duty payable is as follows -				
		Duty %	**Amount**	**Total Duty**
(A)	Assessable Value Rs 10,000		10,000.00	
(B)	Basic Customs Duty	10	1,000.00	1,000.00
(C)	Sub-Total for calculating CVD '(A+B)'		11,000.00	
(D)	CVD 'C' x excise duty rate	14	1,540.00	1,540.00
(E)	Education cess of excise - 2% of 'D'	2	30.80	30.80
(F)	SAH Education cess of excise - 1% of 'D'	1	15.40	15.40
(G)	Sub-total for edu cess on customs 'B+D+E+F'		2,586.20	
(H)	Edu Cess of Customs - 2% of 'G'	2	51.72	51.72
(I)	SAH Education Cess of Customs - 1% of 'G'	1	25.86	25.86
(J)	Sub-total for Spl CVD 'C+D+E+F+H+I'		12,663.78	
(K)	Special CVD u/s 3(5) - 4% of 'J'	4	506.55	506.55
(L)	Total Duty			**3,170.33**
(M)	Total duty rounded to	Rs		3,170
	Notes – Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above.			
	A trader who sells imported goods in India after charging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above			

5.2.1 Additional Customs Duty u/s 3(1) (CVD)

- CVD (Countervailing Duty) is payable on imported goods u/s 3(1) of Customs Tariff Act to counterbalance impact of excise duty on indigenous manufactures, to ensure level paying field.
- CVD is payable equal to excise duty payable on like articles if produced in India. It is payable at effective rate of excise duty, which is generally 16.48%.
- CVD is payable on assessable value plus basic customs duty. In case of products covered under MRP provisions, CV duty is payable on MRP basis as per section 4A of Central Excise.
- CVD can be levied only if there is 'manufacture'.
- CVD is neither excise duty nor basic customs duty levied under Customs Act. However, all provisions of Customs Act apply to CVD.

5.2.2 Additional Duty under section 3(5) (Special CVD - SAD)

Section 3(5) of Customs Tariff Act empowers Central Government to impose additional duty. This is in addition to Additional Duty leviable u/ss 3(1) and 3(5) of Customs Tariff Act. Provision for this duty has been made w.e.f. 1-3-2005. Purpose of the Additional Duty is to counterbalance sales tax, VAT, local tax or other charges leviable on articles on its sale, purchase or transaction in India.

The obvious intention is to provide level playing field to manufacturers in India who are manufacturing similar goods. Hence, it is termed as 'Special CVD" or 'SAD' (Special Additional Duty).

Exemption from SAD - Some categories of imports have been exempted from this special CVD (SAD), vide customs notification No. 20/2006-Custom dated 1-3-2006. The main among these are: Articles of jewellery attracts a lower rate of special CVD at 1%.

Departmental clarifications - Department has clarified as follows, vide MF(DR) circular No. 18/2006-Cus dated 5-6-2006 –

- Special CVD of 4% is not leviable in case of imports under advance authorisation, EOU, EPCZ and SEZ schemes
- In case of export promotion schemes like DEPB, target plus, service from India, DFCE and Vishesh Krishi and Gram Udyog Yojana, 4% Special CVD is required to be debited to the duty scrip/entitlement certificate.
- In case of DFRC scheme, 4% special CVD is payable.
- Duty debited through DEPB, DFCE, target plus scheme etc. will be eligible for Cenvat credit or duty drawback.

Refund of Special CVD to traders – Traders selling imported goods in India after charging sales tax/Vat can claim refund of special CVD from customs department – Notification No. 102/2007-Cus dated 14-9-2007.

5.2.3 Anti-Dumping Duty

- Antidumping duty is leviable u/s 9A of Customs Tariff Act when foreign exporter exports his good at low prices compared to prices normally prevalent in the exporting country.
- Dumping is unfair trade practice and the anti-dumping duty is levied to protect Indian manufacturers from unfair competition.
- Margin of dumping is the difference between normal value (i.e. his sale price in his country) and export price(price at which he is exporting the goods).
- Price of similar products in India is not relevant to determine 'margin of dumping'.

- 'Injury margin' means difference between fair selling price of domestic industry and landed cost of imported products. Dumping duty will be lower of dumping margin or injury margin.
- Benefits accruing to local industry due to availability of cheap foreign inputs is not considered. This is a drawback.
- CVD is not payable on antidumping duty. Education cess and SAH education cess is not payable on anti-dumping duty
- In case of imports from WTO countries, antidumping duty can be imposed only if it cause material injury to domestic industry in India.
- Dumping duty is decided by Designated Authority after enquiry and imposed by Central Government by notification. Provisional antidumping duty can be imposed.
- Appeal against antidumping duty can be made to CESTAT.

5.3 VALUATION IN CUSTOMS

- Customs duty is payable as a percentage of 'Value' often called '*Assessable Value*' or '*Customs Value*'. The **Value** may be either (*a*) 'Value' as defined in section 14(1) of Customs Act or (*b*) Tariff value prescribed under section 14(2) of Customs Act (section amended w.e.f. 10-10-2007)
- Transaction value at the time and place of importation or exportation, when price is sole consideration and buyer and sellers are unrelated is the basic criteria for 'value' u/s 14(1) of Customs Act. Thus, CIF value in case of imports and FOB value in case of exports is relevant.
- In case of high sea sale, price charged by importer to assessee would form the assessable value and not the invoice issued to the importer by foreign supplier. – *National Wire* v. *CC* 2000(122) ELT 810 (CEGAT) * *Godavari Fertilizers* v. *CC* (1996) 81 ELT 535 (CEGAT).
- Rate of exchange will be as determined by CBE&C or ascertained in manner determined by CBE&C.
- Valuation for customs is required to be done as per provisions of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007
- CIF value of goods plus 1% landing charges is the basis for deciding 'Assessable Value'.
- Commission to local agents, packing cost, value of goods and toolings supplied by buyer, royalty relating to imported goods are addible.
- Interest on deferred payment, demurrage and value of computer software loaded is not to be added.
- Old machinery and old cars are often valued on basis of depreciated value, though such method has no sanction of law.

5.3.1 Additions to 'Customs Value'

Rule 10 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [Rule 9 upto 10-10-2007] provide that following cost and services are to be added, *if these are not already included in the invoice price. –*

- Commission and brokerage, except buying Commission, if not already included in the invoice price [rule 10(1)(a)(i)].
- Cost of container which are treated as being one with the goods for customs purposes, if not already included in the invoice price [rule 10(1)(a)(ii)].
- Cost of packing whether labour or materials, if not already included in the invoice price [rule 10(1)(a)(iii)].
- Materials, components, tools, dies, moulds, and consumables used in production of imported goods, supplied by buyer directly or indirectly, free of charge or at reduced cost, to the extent not already included in price [rule 10(1)(b)(i), (ii) and (iii)]
- Engineering, development, art work, design work, plans and sketches undertaken elsewhere than in India and necessary for production of imported goods, to the extent not already included in price [rule 10(1)(b)(iv)].
- Royalties and license fees relating to imported goods that buyer is required to pay, directly or indirectly, as a condition of sale of goods being valued [rule 10(1)(c)]
- Value of proceeds of subsequent resale, disposal or use of goods that accrues directly or indirectly to seller (i.e. to foreign exporter) [rule 10(1)(d)]
- All other payments made as condition of sale of goods being valued made directly or to third party to satisfy obligation of seller, to the extent not included in the price [rule 10(1)(e)]
- Cost of transport upto place of importation [rule 10(2)(a)]
- Loading, unloading and handling charges associated with delivery of imported goods at place of importation [These are termed as landing charges and are to be taken as 1%] [rule 10(2)(b)]
- Cost of insurance [rule 10(2)(c)]

The additions should be on the basis of objective and quantifiable data [rule 10(3) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9(3)].

No other additions - No other addition shall be made to price paid or payable, except as provided for in rule 10.

Royalty payment un-connected with imported goods not to be added - UOI v. *Mahindra and Mahindra Ltd.* 76 ELT 481 = 1995 AIR SCW 1519 (SC) * *S D Technical Service* v. *CC* 2003 (155) ELT 274 = 56 RLT 970 (CEGAT 3 member bench).

Barging/lighterage charges includible – explanation to rule 10(2) (w.e.f. 10-10-2007)

Landing charges of 1% of CIF value to be added - Rule 10(2)(b).

Ship demurrage includible w.e.f. 10-10-2007 - explanation to rule 10(2)

5.3.2 Exclusions from Assessable Value

Interpretative Note to rule 3 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007provide that following charges shall be excluded :

- (a) Charges for construction, erection, assembly, maintenance or technical assistance undertaken *after* importation of plant, machinery or equipment
- (b) Cost of transport *after* importation
- (c) Duties and taxes in India

Other payments from buyer to seller *that do not relate* to imported goods are not part of the customs value.

Demurrage charges payable to port trust authorities for delay in clearing goods are not to be added . - *Deepak Fertilisers* v. *CC* 1989(41) ELT 550 (CEGAT) * *Hindustan Lever* v. *UOI* 2002(142) ELT 33 (Cal HC). [However, ship demurrage is includible w.e.f. 10-10-2007].

Ship demurrage includible w.e.f. 10-10-2007 - explanation to rule 10(2)

5.3.3 Methods of Valuation

The methods of valuation for customs methods are as follows -

- Transaction Value of Imported goods [Section 14(1) and Rule 3(1)]
- Transaction Value of Identical Goods [Rule 4]
- Transaction Value of Similar Goods [Rule 5]
- Deductive Value which is based on identical or similar ***imported*** goods sold in India [Rule 7]
- Computed value which is based on cost of manufacture of goods plus profits [Rule 8]
- Residual method based on reasonable means and data available [Rule 9]

Methods to be applied sequentially - These methods are to be applied in sequential order, i.e. if method one cannot be applied, then method two comes into force and when method two also cannot be applied, method three should be used and so on. The only exception is that the 'computed value' method may be used before 'deductive value' method, if the importer requests and Assessing Officer permits.

5.3.4 Rejection of' Value' -

Importer has to declare 'value' of goods. If the assessing officer has reason to doubt about truth or accuracy of the value declared by the importer, he can ask the importer to submit further information and evidence. If the customs officer still has *reasonable doubt,* he can reject the 'value' as declared by the importer. [rule 12(1) w.e.f. 10-10-2007 – earlier rule 10A(1) of Customs Valuation Rules added w.e.f. 19-2-1998]. If the importer requests, the assessing officer has to give reasons for doubting the truth or accuracy of value declared by importer. [rule 12(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 – earlier rule 10A(2) of Customs Valuation Rules upto 10-10-2007].

Rule 12 is only mechanism to reject the declared value – As per *explanation* (1)(i) to rule 12, the Rule 12 does not provide any method for determination of value. It only provides mechanism to reject declared value, where there is reasonable doubt. If transaction value is rejected, valuation has to be done as per rule 4 to 9 [*Explanation* (1)(i) to rule 12 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

5.3.5 Export Goods - Valuation for Assessment

Customs value of export goods is to be determined under section 14 of Customs Act, read with Customs Valuation (Determination of Value of Export Goods), Rules, 2007. Transaction value at the time and place of exportation, when price is sole consideration and buyer and sellers are unrelated is the basic criteria If there is no sale or buyer or seller are related or price is not the sole consideration, value of the goods will be determined as per Valuation Rules [Clause (ii) of second proviso to section 14(1)].

Valuation when buyer and seller are related – Definition of related person as per rule 2(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007 is same as per definition of rule 2(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

As per rule 3(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007, the transaction value, the transaction value will be accepted as 'value' even if buyer and seller are 'related', if the relationship has not influenced price.

Valuation if value cannot be determined on basis of transaction value – If valuation is not possible on basis of transaction value, valuation will be done by proceeding sequentially through rules 4 to 6 [Rule 3(3) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007].

The methods are - Export value by comparison on the basis of transaction value of 'goods of like kind and quality' exported at or about the same time to other buyers in same destination country [Rule 4}, Computed value on basis of cost of production plus profit [Rule 5] and Residual method using reasonable means consistent with principles and general provisions of rules [Rule 6].

Rejection of value as declared by exporter - As per rule 7 of Customs Valuation (Determination of Value of Export Goods) Rules, 2007, the exporter has to file declaration about full 'value' of goods. If the assessing officer has doubts about the truth and accuracy of 'value' as declared, he

can ask exporter to submit further information, details and documents. If the doubt persists, the assessing officer can reject the value declared by importer. [rule 8(1) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007]. If the exporter requests, the assessing officer has to give reasons for doubting the value declared by exporter. [rule 8(2)].

Rule 8 is only mechanism to reject the declared value – As per *explanation* (1)(i) to rule 8, the Rule 8 does not provide any method for determination of value. It only provides mechanism to reject declared value, where there is reasonable doubt.

Declared value shall be accepted if assessing officer is satisfied about truth and accuracy of the declared value [Explanation (1)(ii) to rule 8 of Customs Valuation (Determination of Value of Export Goods) Rules, 2007].

5.4 PROCEDURES FOR IMPORT

- Goods should arrive at customs port / airport only.
- Person in charge of conveyance is required to submit Import Manifest or Export Manifest.
- Goods can be unloaded only after grant of 'Entry Inwards'.
- Importer has to submit Bill of Entry giving details of goods being imported, along with required documents. Electronic submission of documents is to be done in many ports.
- Goods are assessed to duty, examined and customs duty is paid. Bond is executed if required.
- Goods can be cleared from port after 'Out of Customs Charge' order is issued by customs officer.
- Self Assessment on basis of 'Risk Management System' (RNS) has been introduced in some ports in respect of specified goods and importers.
- Demurrage is payable if goods are not cleared within three days from port. Goods can be disposed of if not cleared within 30 days.

Overview of procedures for import - The broad procedures to be followed for assessment and clearance of imported goods are as follows –

- Importer to submit Bill of Entry giving details of goods to be cleared from customs
- Bill of Entry can be for home consumption (i.e. clearance after payment of duty) (white colour) or for warehousing (keeping in warehouse without payment of duty and later clearing on payment of duty when required) (yellow colour)
- Importer to submit other documents like Invoices, contracts, product literature, packing lists, import license etc. so that customs officer can assess the imported goods under clearance
- Noting of Bill of Entry by customs officer

- Examination of goods and assessment by customs officer (if first appraisement system) or assessment of goods on basis of documents (if second appraisement system)
- Pre-audit by customs department
- Customs Officer to approve assessment (valuation of goods) on the Bill of Entry and return to importer
- Importer to execute bond if clearance at concessional rate of duty subject to some conditions or clearance is under provisional assessment
- Importer to pay duty, if clearance is for home consumption or execute bond, if clearance is for warehousing
- Inspection of goods (if assessment was under second appraisement system)
- Out of customs charge order by customs officer
- Pay dues of port trust, pay demurrage (if applicable), pay other dues
- Transport the goods from customs

These procedures are for import by ship / air / road. There is separate procedure for goods imported as a baggage or by post.

Submission of Bill of Entry - Bill of Entry is a very vital and important document which every importer has to submit to customs officer in respect of imported goods other than goods intended for transit or transhipment. Bill of Entry should be in prescribed form. It can be either for home consumption or for warehousing [section 46(1)]. It should include all goods mentioned in Bill of Lading or other receipt given by carrier to consignor [section 46(2)]. Importer has to declare that contents of Bill of Entry are true [section 46(4)]

- White Bill of Entry is for home consumption. Imported goods are cleared on payment of customs duty.
- Yellow Bill of Entry is for warehousing. It is also termed as 'into bond Bill of Entry' as bond is executed. Duty is not paid and imported goods are transferred to warehouse where these are stored.
- Green Bill of Entry is for clearance from warehouse on payment of customs duty. It is for ex-bond clearance.

Documents to be submitted by Importer - Documents required by customs authorities are required to be submitted to enable them to (*a*) check the goods (*b*) decide value and classification of goods and (*c*) to ensure that the import is legally permitted. *The documents that are essentially required are* : (i) Invoice (ii) Packing List (iii) Bill of Lading / Delivery Order (iv) GATT declaration form duly filled in (v) Importers / CHAs declaration duly signed (vi) Import License or attested photocopy when clearance is under license (vii) Letter of Credit / Bank Draft wherever necessary (vii-a) Insurance memo or insurance policy (viii) Industrial License if required (ix) Certificate of country of origin, if preferential rate is claimed. (x) Technical litera-

ture. (xi) Test report in case of chemicals (xii) Advance License / DEPB in original, where applicable (xiii) Split up of value of spares, components and machinery (xiv) No commission declaration. – A declaration in prescribed form about correctness of information should be submitted. – *Chapter 3 Paras 6 and 7 of CBE&C's Customs Manual, 2001.*

Electronic submission under EDI system – Customs work at many ports has been computerised. In that case, the Bill of Entry has to be filed electronically, i.e. through Customs EDI system through computerisation of work. Procedure for the same has been prescribed vide Bill of Entry (Electronic Declaration) Regulations, 1995.

5.5 EXPORT PROCEDURES

The broad procedures to be followed for exports are as follows –

- Submit Shipping Bill for export to customs authorities
- Submit invoice, packing lists, contracts, export license (if applicable) and other related documents
- Submit necessary declarations for export. Submit * GR / SDF / SOFTEX form as required under FEMA * Excise ARE-1 form
- Noting of Shipping Bill by customs officer
- Assessment i.e. valuation and classification of goods. Checking of Advance License, if applicable
- Custom check whether export is restricted / prohibited
- Examination of goods by customs officer
- Pay export duty, if applicable
- Stuffing of container, if not already done
- 'Let export' Order by customs officer
- Obtain ARE-1 form duly signed by customs officer. Obtain Bill of Lading from shipping company. Submit proof of export to excise authorities.
- Complete formalities relating to claim of duty drawback.

Initial steps by exporter - Every exporter should take following initial steps -

- Obtain BIN (Business Identification Number) from DGFT. It is a PAN based number
- Open current account with designated bank for credit of duty drawback claims
- Register licenses / advance license / DEPB etc. at the customs station, if exports are under Export Promotion Schemes

RCMC certificate from Export Promotion Council - Various Export Promotion Councils have been set up to promote and develop exports (e.g. Engineering Export Promotion Council, Apparel Export Promotion Council, etc.) Exporter has to become member of the concerned Export Promotion Council and obtain RCMC - Registration cum membership Certificate.

Exporter should apply for registration with EPC that relates to his main line of business. However, exporter can take membership of any other EPC in addition – DGFT circular No. 2/2004-09 dated 6-10-2004.

Third party exports - Third party exports means exports made by an Exporter or Manufacturer on behalf of another exporter/s. The Shipping Bill shall indicate the names of both the exporter/manufacturer and exporter. The BRC, GR declaration, export order and the Invoice shall be in name of the third party exporter [para 9.62 of FTP]

SEZ unit can export goods or software through a merchant exporter/status holder.

Merchant Exporter - Merchant Exporter means a person engaged in trading activity and exporting or intending to export goods [para 9.40 of FTP].

5.6 BAGGAGE, COURIER AND IMPORT THROUGH POST

- Baggage includes unaccompanied baggage but does not include motor vehicles [section 2(3)]
- Indians going out can take out any amount of foreign currency as long as it is obtained from authorised foreign exchange dealer. He can take out and bring in Indian currency only upto Rs 1,000.
- Baggage includes all dutiable articles imported by passenger or crew but does not include motor vehicles, alcoholic drinks (beyond limits) and goods imported through courier.
- Incoming passenger with no dutiable goods can pass through green channel.
- General rate of duty on import of baggage is 36.05% (35% basic customs duty plus 2% education cess plus 1% SAH education cess). One laptop computer is exempt.
- *Bona fide* luggage including used personal effects are exempt from customs duty. In addition to bona fide luggage and one laptop computer, Indian resident or foreigner residing in India over 12 years of age is allowed general free allowance (GFA) of Rs 25,000, after stay abroad for more than three days. GFA is lower when passenger comes from some countries like Nepal, Bhutan, Myanmar or China.
- Besides GFA, one laptop can be imported free of customs duty.
- GFA cannot be clubbed with other person.

- If a person comes after 6 months of stay, he can bring gold upto 10 Kg on payment of customs duty @ Rs 250 per 10 gms (plus education cess) and silver upto 100 Kg on payment of customs duty @ Rs 500 per Kg (plus education cess)
- Commercial samples can be brought in or taken out within prescribed limits.
- Additional concession is available if a person transfers his residence after stay abroad for two years. He is eligible for concessional rate of 15% duty (plus 2% education cess) of goods upto Rs 5 lakhs. In case of some goods, duty is Nil. He is also entitled to GFA.
- In case of mini TR (i.e. person returning after 365 days), used personal effects and household articles upto Rs 75,000 can be brought duty free, in addition to GFA. However, items specified in Annex I, II and III as specified in Baggage Rules are not allowed duty free.
- Foreign tourists can bring personal effects and travel souvenirs free of duty. Articles upto Rs 8,000 can be brought as gifts duty free.
- If value of foreign currency notes exceeds US $ 5,000 or aggregate value of foreign exchange (in the form of currency note, bank notes, traveller cheques etc.) exceeds US $ 10,000, the passenger has to make declaration in Currency Declaration Form (CDF).
- Unaccompanied baggage can be brought. GFA is not allowed on unaccompanied baggage.

Import and export through Courier - Imports and export through couriers are treated as imports or exports as any other mode. It is not treated as 'baggage'. There is no restriction on value of goods that can be brought through courier. The duty payable is normal duty as applicable to all other goods normally imported by ship or air transport. Duty concessions, if any, are also permissible. Courier Imports and exports (Clearance) Regulations, 1998 specify the procedures, which are summarised in Chapter 17 of CBE&C's Customs Manual, 2001.

Import through post

- Label / declaration on postal article is treated as 'Entry'. Separate Bill of Entry is not required.
- Postal articles are sent to Foreign parcel Department of Post Office. The list is handed over to Principal Appraiser of Customs.
- He will inspect mail. Packets suspected of dutiable articles will be opened and examined by him . He will assess the goods and then seal the parcel.
- Goods will be handed by postmaster to addressee only on receipt of customs duty payable on the goods.
- Gifts upto Rs 10,000 are free. Post parcel is exempt if customs duty is upto Rs 100.

5.7 OTHER PROVISIONS IN CUSTOMS

5.7.1 Exemptions and remission

- Exemption can be granted by Government by issuing a notification.
- Capital goods and spares can be imported under project imports at concessional rate of customs duty.
- Remission can be obtained on goods lost / pilfered in port
- Title of imported goods can be relinquished and then no customs duty will be payable.
- Goods exported can be re-imported. Concessional customs duty is payable in most of such re-imports.

5.7.2 Warehousing in customs

- Imported goods can be kept in customs warehouse without payment of customs duty.
- Goods can be kept in warehouse awaiting receipt of import authorisation.
- Goods can be kept in warehouse upto one year, but interest is payable beyond 90 days, @ 15%.
- Goods can be manufactured in warehouse and exported without payment of customs duty. This facility is useful to EOU.
- Warehoused goods cane be (a) Cleared on payment of duty (b) Cleared for export without payment of duty or (c) transferred to another warehouse without payment of duty.

5.7.3 Penalties under Customs Act

- Smuggling in relation to goods is an act or omission which will make the goods liable to confiscation.
- Penalty can be imposed for improper imports or improper exports.
- Monetary penalty upto value of goods or Rs 5,000 whichever is higher can be imposed.
- Goods can be confiscated. Permission can be granted for re-export of offending goods..
- In case of goods covered under section 123 of Customs Act, burden of proof that the goods are not smuggled goods is on the accused.

STUDY NOTE - 6

SOME CRITICAL ISSUES IN CUSTOMS LAW

This Study Note includes

- Refund of Special CVD of Customs to Traders
- Anti Dumping Duty on dumped articles
- Value for Purpose of Customs Act
- Methods of Valuation of Imported Goods
- Valuation of Export Goods
- Self Assessment on basis of 'Risk Management System'(RMS)

6.1 REFUND OF SPECIAL CVD OF CUSTOMS TO TRADERS

Traders selling imported goods in India after charging sales tax/Vat can claim refund of special CVD of 4% from customs department – Notification No. 102/2007-Cus dated 14-9-2007. The dealer (trader) (if he is registered with Central Excise and is issuing Cenvatable Invoice) selling such imported goods must mention in his invoice that the buyer will not be able to avail Cenvat credit of such duty. This is required if he is claiming refund of the special CVD. If he is not claiming refund, obviously, such remark is not required.

A manufacturer using these goods in his manufacture can avail Cenvat credit of this duty. Thus, he gets credit through central excise route.

6.2 ANTI DUMPING DUTY ON DUMPED ARTICLES

Often, large manufacturer from abroad may export goods at very low prices compared to prices normally prevalent in export market. Such dumping may be with intention to cripple domestic industry ***or*** to dispose of their excess stock. This is called 'dumping' and is an unfair trade practice. In order to avoid such dumping and to protect domestic industry, Central Government can impose, under section 9A of Customs Tariff Act, anti-dumping duty, if the goods are being sold at less than its normal value. Levy of such anti-dumping duty is permissible as per WTO agreement. Anti dumping action can be taken only when there is an Indian industry producing 'like articles'.

In *Shenyang Mastusushita* v. *Exide Batteries* 2005 (181) ELT 320 (SC 3 member bench), it was observed, 'Principle behind anti-dumping laws is to protect the domestic industry from being adversely affected by import of goods at export prices which are below the normal value of the goods in the domestic market of the exporter. The duty is calculated on the margin of dumping which is the difference between the export price and the normal value'.

In *SS Enterprise* v. *Designated Authority* AIR 2005 SC 1527 = 181 ELT 375 (SC 3 member bench), it was held that purpose being imposition of anti-dumping duty is to curb unfair trade practices resorted to by exporters of a particular country of flooding the domestic markets at rates which are lower than the rate at which the exporters normally sell the same or like goods in

their own countries, so as to cause or be likely to cause injury to the domestic market. The levy of dumping duty is a method recognised by GATT (*should be WTO*) which seeks to remedy the injury and at the same time balances the rights of exporters from other countries to sell their products within the country with the interest of domestic markets. Thus the factors to constitute 'dumping' is (i) an import at prices which are lower than the normal value of goods in exporting country (ii) the exports must be sufficient to cause injury to domestic industry. - - However, negligible quantity of imports would not be sufficient to cause such injury.

Presently, countries like China, Taiwan are said to be involved in dumping. Even Indian steel exporters are facing charges of dumping goods in USA.

Provisional anti-dumping duty - Pending determination of margin of dumping, duty can be imposed on provisional basis. After dumping duty is finally determined, Central Government can reduce such duty and refund duty extra collected than that finally calculated. Such duty can be imposed upto 90 days prior to date of notification, if there is history of dumping which importer was aware or where serious injury is caused due to dumping.

No CVD on anti dumping duty - Anti Dumping Duty and Safeguard Duty is not required to be considered while calculating CVD – view confirmed in *Tonira Pharma* v. *CCE* (2007) 208 ELT 38 (CESTAT 2 v. 1 order).

No education cess and SAHE cess on anti-dumping duty – Education cess and SAH education cess is not payable on anti-dumping duty.

No anti dumping duty in case of imports by EOU and SEZ - Anti-dumping duty is not applicable for imports by EOU or SEZ units, unless it is specifically made applicable in the notification imposing anti-dumping duty. [section 9A(2A) of Customs Tariff Act]

Margin of Dumping - '*Margin of dumping*' means the difference between normal value and export price (i.e. the price at which these goods are exported). [section 9A(1)(a)].

'*Normal Value*' means comparable price in ordinary course in trade, for like article, when destined for consumption in the exporting country or territory. If such price is not available or not comparable (a) comparable representative price of like article exported from exporting country or territory to appropriate third country or (b) cost of production plus reasonable profit, can be considered [section 9A(1)(c) of Customs Tariff Act]. The 'normal value' is to be determined as per rules.

In *Reliance Industries Ltd.* v. *Designated Authority* 2006 (202) ELT 23 (SC), it was held that 'normal value' are not exporter specific but exporting country specific. Once dumping of specific goods from a country is established, dumping duty can be imposed on all exports of those goods from that country in India, irrespective of the exporter. Rate of duty may vary from exporter to exporter depending upon the export price.

'*Export Price*' means the price at which goods are exported. If the export price is unreliable due to association or compensatory arrangement between exporter and importer or a third party, export price can be constructed (revised) on the basis of price at which the imported articles are first sold to independent buyer or according to rules made for determining margin of dumping. [section 9A(1)(b)].

Margin of dumping is determined on basis of weighted average of 'normal value' and the 'export price' of product under consideration.

Quantum of dumping duty - The anti-dumping duty will be dumping margin or injury margin, *whichever is lower*. 'Injury margin' means difference between fair selling price of domestic industry and landed cost of imported product. The landed cost will include landing charges of 1% and basic customs duty. Thus, only anti-dumping duty enough to remove injury to domestic industry can be levied.

For example, if normal value in exporting country is Rs 11 and export price is Rs 8, dumping margin is Rs 3. If landed cost is Rs 9 and fair selling price of domestic industry is Rs 10, then injury margin is Re 1/-. Hence, anti-dumping duty of only Re 1 can be imposed.

In *Reliance Industries Ltd.* v. *Designated Authority* 2006 (202) ELT 23 (SC), it was held that non-injurious price (NIP) has to be calculated for domestic industry as a whole and not in respect of any particular company or enterprise. [Hence, even if product is captively consumed by Indian manufacturer, transfer price (market value) of inputs is to be considered and not actual cost of captive consumption]. It was observed that there has to be a single NIP for a product and not several NIP for the same product. NIP is not exporter specific.

In *Alkali Manufacturers Association of India* v. *Designated Authority* 2006 (194) ELT 161 (CESTAT). Designated Authority had calculated domestic price on basis of profit of 22% of investment. It was held that this is reasonable.

Dumping duty for WTO countries - Section 9B of Customs Tariff Act provides restrictions on imposing dumping duties in case of imports from WTO countries or countries given 'Most Favoured Nation' by an agreement. Dumping duty can be levied on import from such countries, only if Central Government declares that import of such articles in India causes material injury to industry established in India or materially retards establishment of industry in India. [WTO agreement permits levy of anti-dumping duty when it causes injury to domestic industry as a result of specific unfair trade practice by foreign producer, by selling below normal value].

'Injury to domestic industry' will be considered on basis of volume effect and price effect on Indian industry. There must be a 'casual link' between material injury being suffered by dumped articles and the dumped imports.

Rules for deciding subsidy or dumping margin - Central Government has been empowered to make rules for determining (*a*) subsidy or bounty in case of bounty fed goods (*b*) the normal value and export price to determine margin of dumping in case of dumping. Accordingly, Customs Tariff (Identification, Assessment and Collection of Anti-dumping duty on Dumped Articles and for determination of Injury) Rules, 1995 [*Customs Notification No. 2/95 (N.T.) dated 1-1-95*] provide detailed procedure for determining the injury in case of dumped articles.

Procedure for fixing anti dumping duty - After the 'designated authority' is satisfied about *prima facie* case, he will give notice to Governments of exporting countries. Opportunity to inspection of documents and making representations will be given to interested parties who are likely to be affected. Designated Authority will first give preliminary finding and then final

finding within one year. Provisional duty can be imposed on basis of preliminary finding which can continue upto 6 months, extendable to 9 months. Additional duty may be imposed on basis of the final finding.

As per rule 18 of Anti-Dumping Duty Rules, Central Government has to issue a notification fixing anti-dumping duty within three months from date of notification issued by designated authority.

Appeal against order determining dumping duty - Appeal against the order determining the duty can be made to CESTAT. The appeal will be heard by at least three member bench consisting of President, one judicial member and one technical member [section 9C of Customs Tariff Act].

No appeal against order of Tribunal – Section 9C does not provide for statutory appeal against order of Tribunal. Hence, only remedy is either writ in High Court or SLP in Supreme Court.

High Court should not exercise writ jurisdiction – In view of appeal provisions, High Court should not entertain writ petitions and grant interim relief. Otherwise, the provisions of appeal would be rendered otiose – *Association of Synthetic Fibre Industry* v. *J K Industries* 2006 (199) ELT 196 (SC) * *Nitco Tiles* v. *Gujarat Ceramic Floor Tiles Mfg Association* 2006 (199) ELT 198 (SC).

Mid-term review – Mid-term review of anti-dumping duty is permissible under rule 23 of Anti-Dumping Duty Rules. In *Rishiroop Polymers* v. *Designated Authority* 2006 (196) ELT 385 (SC), it was held that scope of review enquiry by Designated Authority is limited to the satisfaction as to whether there is justification for continuing imposition of anti-dumping duty. The inquiry is limited to change in various parameters like normal value, export value, dumping margin, fixation of non-injury price and injury to domestic industry. Only changed parameters should be considered

New Shipper Review – After imposing of anti-dumping duty, a new exporter may want to export same goods to India. As per rule 22, if he had not exported earlier, he can ask for review of anti-dumping duty. During the period of review, Government may resort to provisional assessment and may allow imports on submission of guarantee, pending review. If anti-dumping duty is determined, it will be payable retrospectively from date of initiation of review. Such review is termed as 'new Shipper Review'.

Discontinuation of anti-dumping duty i.e. sunset review - Anti dumping duty ceases on the expiry of five years from date of imposition. However, Central Government can extend the anti-dumping duty, if it is of the opinion that cessation is likely to lead to continuation or recurrence of dumping and injury.

Practical example on anti-dumping duty **– An importer imported Description of goods**: **Mulberry Raw Silk (not thrown) (HS Code 5002 00) from People's Republic if China. CIF value was US $ 20,000 and quantity 1,000 Kgs. Exchange rate was 1 US $ = Rs. 44 on date of presentation of Bill of Entry. Customs Duty rates are – (i) Basic Customs Duty 30% (ii) Education Cess 2% (iii) SAH Education cess - 1%. There is no excise duty payable on these goods if manufactured in India. As per Notification No. 106/2003-Cus dated 10-7-2003, anti-dumping duty has been imposed on these goods imported from China, manufactured by any pro-**

ducer in People's Republic of China. The anti-dumping duty will be equal to difference between amount calculated @ US $ 27.97 per Kg and 'landed value' of goods. Compute Customs Duty liability & anti-dumping liability.

Answer – (a) Computation of Customs duty:-

Total CIF Price	US $	20,000
CIF @ Rs 44 = 1 US $	Rs	8,80,000.00
Add – Landing charges @ 1%	Rs	8,800.00
Assessable Value	Rs	8,88,800.00
Basic duty @ 30%	Rs	2,66,640.00
Education Cess @ 2% on 2,66,640.00	Rs	5,332.80
SAH education Cess 1%		2,666.40
Total Customs Duty payable (Basic + Education Cess)	Rs	2,74,639.20
Rounded to	Rs	2,74,639.00

b) Computation of landed value

Assessable Value Under Customs Act,	Rs	8,88,800.00
Add: All Duties of Customs	Rs	2,74,639.00
Landed Value as per Anti-Dumping Notification	Rs	11,63,439.00

c) Computation of anti-dumping duty

Rate of Silk Yarn as per Anti Dumping Notification.(US $ 27.97 per Kg)	US $	27,970
Value @ Rs 44 = 1 US $	Rs	12,30,680.00
Less:		
Landed Value as per Anti-Dumping Notification	Rs	11,63,439.00
Anti Dumping Duty payable	Rs	67,241.00

Thus, anti-dumping duty payable will be Rs 67,241.

6.3 VALUE FOR PURPOSE OF CUSTOMS ACT

Customs duty is payable as a percentage of 'Value' often called '*Assessable Value*' or '*Customs Value*'. The **Value** may be either (*a*) 'Value' as defined in section 14(1) of Customs Act or (*b*) Tariff value prescribed under section 14(2) of Customs Act.

The provisions relating to customs valuation have been completely revamped by introducing new section 14 w.e.f. 10-10-2007.

Tariff Value - Tariff Value can be fixed by CBE&C (Board) for any class of imported goods or export goods. CBE&C should consider trend of value of such or like goods while fixing tariff value. Once so fixed, duty is payable as percentage of this value. (The percentage applicable is as prescribed in Customs Tariff Act). Fixing tariff value is not permitted under GATT convention. However, the provision of fixing tariff values has been retained.

Tariff value for crude palm oil, RBD Palmolein, palm oil, crude soyabean oil and brass scrap has been fixed by notification No. 36/2001-Cus (NT) dated 3-8-2001.

Customs Valuation on basis of transaction value - New section 14(1) of Customs Act (effective from 10-10-2007) states that 'value' of imported and export goods will be 'transaction value' of such goods i.e. the price actually paid or payable for the goods when sold for export to India for delivery at the time and place of importation, or for export from India for delivery at the time and place of exportation, where the buyer and seller of the goods are not related and price is the sole consideration for the sale, subject to such other conditions as may be specified in the rules made in this behalf.

Accordingly Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 and Customs Valuation (Determination of Value of Export Goods) Rules, 2007 have been notified effective from 10-10-2007.

Section 2(41) of Customs Act has also been amended as follows w.e.f. 10-10-2007 - 'value', in relation to any goods, means the value thereof determined in accordance with the provisions of sub-section (1) or sub-section (2) of section 14.

Addition to transaction value – *First proviso* to new section 14(1) states that such transaction value in the case of imported goods shall include, in addition to the price as aforesaid [i.e. as specified in section 14(1)], any amount that the buyer is liable to pay for costs and services, including commissions and brokerage, engineering, design work, royalties and licence fees, costs of transportation to the place of importation, insurance, loading, unloading and handling charges to the extent and in the manners specified in the Rules.

Though the *proviso* does not specifically say so, it is obvious that only those expenses which are relating to imported goods alone can be added.

Rate of foreign exchange - Third *proviso* to new section 14(1) states that such price shall be calculated with reference to the rate of exchange as in force on the date on which a bill of entry is presented under section 46, or a shipping bill or bill of export, as the case may be, is presented under section 50. As per *Explanation* (a) to section 14(2), the rate of exchange will be determined by CBE&C or ascertained in such manner as CBE&C may direct.

Tariff value - New section 14(2) empowers CBE&C to fix tariff values of imported goods or export goods by issuing a notification.

Valuation Rules if transaction value is not determinable - If there is no sale or buyer or seller are related or price is not the sole consideration, value of the goods will be determined as per Valuation Rules [Clause (ii) of second proviso to section 14(1)].

Valuation for CVD when goods are under MRP provisions - In respect of some consumer goods, excise duty is payable on basis of MRP (Maximum Retail Price) printed on the carton. If such goods are imported, CVD will be payable on basis of MRP printed on the packing. See discussions under 'CVD' in previous chapter.

Sale to related person – Transaction value is not acceptable if buyer and seller are 'related'. Definition of 'related person' is identical in rule 2(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 and rule 2(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007. The definition is discussed in a later chapter.

6.3.1 Transaction value at the time and place of importation

Price should be for delivery at the place of importation – Value at the place of importation does not mean that only expenses till goods enter Indian Customs water should be included. Import is an integrated process which culminates when goods land on land-mass of India so that they can be introduced in stream of supplies to form part of mass of goods within the country. Thus, all expenses upto the destination port, including freight, transit insurance, unloading and handling charges are to be included.

Price must be the sole consideration - Price should be sole consideration for sale. If there is other consideration, it should be added to the transaction value.

In *Jindal Photo Films* v. *CC* 2002(141) ELT 202 (CEGAT), it was held that license fee related to know how embedded in machine has to be added to Assessable Value. In this case, the foreign supplier had not charged license fee but had stated that if semi-processed raw material is not purchased from the foreign supplier, flat annual license fee will be payable for seven years. It was thus obvious that price was not the sole consideration and hence the license fee, which was additional consideration, was addible.

Price to include value of intellectual property contained in it – A software cannot be valued on basis of price of CD. In *Globe Entertainment* v. *CC* 2005 (180) ELT 258 (CESTAT), it was held that value of video cassettes cannot be valued on basis of material cost plus recording charges. Value of intellectual property i.e. serial recorded in cassettes has also to be taken into consideration. It is not value of material but value of intellectual property which is recorded in the cassettes.

Inclusions/Exclusions in Customs Value

- Valuation for customs is required to be done as per provisions of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007
- CIF value of goods plus 1% landing charges is the basis for deciding 'Assessable Value'.
- Commission to local agents, packing cost, value of goods and toolings supplied by buyer, royalty relating to imported goods are addible.
- Interest on deferred payment, demurrage at port is not required to be added
- Value of computer software loaded on machine is to be added to value of machinery.
- Old machinery and old cars are valued on basis of depreciated value, though such method has no sanction of law.

6.3.2 Customs Value – Inclusions

Rule 10 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [Rule 9 upto 10-10-2007] provide that following cost and services are to be added, *if these are not already included in the invoice price.* –

- Commission and brokerage, except buying Commission, if not already included in the invoice price [rule 10(1)(a)(i)].
- Cost of container which are treated as being one with the goods for customs purposes, if not already included in the invoice price [rule 10(1)(a)(ii)].
- Cost of packing whether labour or materials, if not already included in the invoice price [rule 10(1)(a)(iii)].
- Materials, components, tools, dies, moulds, and consumables used in production of imported goods, supplied by buyer directly or indirectly, free of charge or at reduced cost, to the extent not already included in price [rule 10(1)(b)(i), (ii) and (iii)]

- Engineering, development, art work, design work, plans and sketches undertaken elsewhere than in India and necessary for production of imported goods, to the extent not already included in price [rule 10(1)(b)(iv)].
- Royalties and license fees relating to imported goods that buyer is required to pay, directly or indirectly, as a condition of sale of goods being valued [rule 10(1)(c)]
- Value of proceeds of subsequent resale, disposal or use of goods that accrues directly or indirectly to seller (i.e. to foreign exporter) [rule 10(1)(d)]
- All other payments made as condition of sale of goods being valued made directly or to third party to satisfy obligation of seller, to the extent not included in the price [rule 10(1)(e)]
- Cost of transport upto place of importation [rule 10(2)(a)]
- Loading, unloading and handling charges associated with delivery of imported goods at place of importation [These are termed as landing charges and are to be taken as 1%] [rule 10(2)(b)]
- Cost of insurance [rule 10(2)(c)]

The additions should be on the basis of objective and quantifiable data [rule 10(3) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9(3)].

No other additions - No other addition shall be made to price paid or payable, except as provided for in rule 10 [rule 10(4) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9(4)]. Interpretative Note to rule 3 (earlier rule 4) also clarifies that activities undertaken by buyer other than those for which adjustments are provided in rule 10 (earlier rule 9) are not to be added, even though it may be regarded as benefit to the seller.

Services / documents / technical know-how supplied by Buyer - Cost of engineering, development, art work, design work and plans and sketches undertaken by buyer which is necessary for production of imported goods is includible, ***only if*** such work is undertaken *outside India.* [Rule 10(1) (b) (iv) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9)]

The addition should be done on objective and quantifiable data. Data available with importer should be used as far as possible. If the services are purchased or leased by importer, such purchase/lease cost should be added. If the importer has himself done the work abroad, its cost should be added on basis of structure and management practices of importer and his accounting methods (in other words, if development work, plans, sketches etc. is done by importer himself *outside India*, its cost should be calculated based on normal accounting practices - like apportionment of overheads, apportionment over various jobs if the same development work, design work etc. is used for more than one jobs etc.) [Interpretative Note to rule 10(1)(b)(iv) of Customs Valuation Rules].

Technical know how related to imported machinery - In *CC* v. *Essar Gujarat Ltd.* (1997) 9 SCC 738 = 88 ELT 609 = 17 RLT 588 (SC 3 member bench), it was held that payment of licence fee and transfer of technology, without which the imported plant could not function, will have to

be added to the value of imported plant. However, training charges cannot be included. - wrongly followed in *CC* v. *Himson Textile Engg. Ltd.* 1997(93) ELT 301 (CEGAT).

Royalties and licence fee - Royalties and license fees related to imported goods that the buyer is required to pay, directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable, are required to be added in assessable value. [Rule 10(1)(c) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9)].

Royalty payment un-connected with imported goods not to be added - Often, a lump-sum payment of royalty is made to foreign collaborators for technical know-how. In addition, components / parts / CKD packs are procured from foreign collaborators. Customs department normally holds that the price of parts / CKD packs should be loaded, on assumption that the part of price of component parts / CKD packs has been paid as 'royalty payment'.

Charges for reproduction of goods in India not to be added - Interpretative Note to rule 10(1)(c) of Customs Valuation Rules makes it clear that charges for right to reproduce the imported goods in India shall not be added.

Barge/lighterage charges includible – In some cases, the ship is not brought upto jetty. Goods are discharged at outer anchorage. This may be for various reasons, e.g. (a) deep draught at port (b) Ports are busy (c) Odd dimensional or heavy lifts or hazardous cargo discharged at anchorage. Charges for brining the goods from outer anchorage are known as 'barging / lighterage charges'.

As per *explanation* to rule 10(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [inserted w.e.f. 10-10-2007], ship demurrage charges on chartered vessels, lighterage or barge charges are includible.

Mode of computation of freight of time chartered / daughter vessel has been specified in MF(DR) circular No. 4 / 2006-Cus dated 12-1-2006.

Landing charges to be added - Cost of unloading and handling associated with delivery of imported goods in port (*called landing charges*) shall be added. These will be calculated @ 1% of CIF value, i.e. FOB price plus freight plus insurance. [Rule 10(2)(b) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 – earlier rule 9].

6.3.3 Exclusions from Assessable Value

Interpretative Note to rule 3 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 provide that following charges shall be excluded :

- (a) Charges for construction, erection, assembly, maintenance or technical assistance undertaken *after* importation of plant, machinery or equipment

- (b) Cost of transport *after* importation



- (c) Duties and taxes in India

Other payments from buyer to seller *that do not relate* to imported goods are not part of the customs value.

6.3.4 Illustrations of computing Customs Value

Question : **An importer imports some goods @ 10,000 US $ on CIF basis. Following dollar rates are available on the date of presentation of bill of entry : (*a*) RBI Floor rate : Rs. 43.37 (*b*) Inter-bank closing rate : Rs. 43.38 (*c*) Rate notified by CBE&C under section 14 (3) (a) (i) of Customs Act : Rs. 43.55 (*d*) rate at which bank has realised the payment from importer : Rs. 43.58. Find the assessable value for customs purposes.**

Answer : The relevant exchange rate is Rs. 43.55. Thus, CIF Value of goods is Rs. 4,35,500. Landing charges [rule 9 (2) of Customs Valuation Rules] @1% of CIF Value are to be added - i.e. Rs. 4,355. Thus, Customs Value or Assessable Value is Rs. 4,39,855.

Question : **A consignment is imported by air. CIF price is 1,000 US Dollars. Freight is 320 US $. Insurance cost was $ 35. Exchange rate is same as above. Find Value for customs purposes.**

Answer : FOB Price of consignment is $ 645 (1,000 less 320 less 35). Air freight is to be restricted to 20% of FOB Value for purpose of customs valuation. Hence, freight should be considered as 20% of 645 i.e. 129 US $ for valuation. Thus, CIF Value for customs purposes is $ 809 (645 + 129 + 35) i.e. Rs. 35,231.95 @ Rs. 43.55 per dollar. Add 1% of CIF i.e. Rs. 352.32 as landing charges. Thus, Value for Customs purposes will be 35,584.27.

Question : **FOB Cost of a consignment is 3,000 UK Pounds. Insurance and transport costs are not available. What is Customs Value ? On the date of filing of bill of entry, Reserve Bank of India reference rate of US $ was 43.37 and inter-bank closing rates were : Rs. 43.38 per US $ and Rs. 69.38 per UK Pound. Exchange rate announced by Board (CBE&C) by customs notification was Rs. 69.78 per British Pound. T T buying rate was 69.70 and T T selling rate was Rs. 69.61 per UK pound.**

Answer : FOB Price is 3,000 UK pounds. Add 20% as freight cost i.e. 600 as actual cost is not available. Since insurance charges are not known, insurance cost should be taken @ 1.125% of FOB price i.e. 33.75. Thus, CIF price is 3,633.75 UK pounds. Conversion rate is 69.78. Hence, CIF Value is Rs. 2,53,563.08 (3,633.75 x 69.78). Landing charges @ 1% of CIF will be Rs. 2,535.63. Thus, Customs Value is Rs. 2,56,098.71

Question : **Customs value (Assessable Value) of imported goods is Rs. 2,00,000. Basic Customs duty payable is 10%. If the goods were produced in India, excise duty payable would have been 16%. Education cess is as applicable. Special CVD is payable at appropriate rates. Find the Customs duty payable. What are the duty refunds/benefits available if the importer is (a) manufacturer (b) service provider (c) Trader?**

Answer :-

		Duty %	Amount	Total Duty
(A)	Assessable Value Rs 10,000		200,000.00	
(B)	Basic Customs Duty	10	20,000.00	20,000.00
(C)	Sub-Total for calculating CVD '(A+B)'		220,000.00	
(D)	CVD 'C' x excise duty rate	16	35,200.00	35,200.00
(E)	Education cess of excise - 2% of 'D'	2	704.00	704.00
(F)	SAH Education cess of excise - 1% of 'D'	1	352.00	352.00
(G)	Sub-total for edu cess on customs 'B+D+E+F'		56,256.00	
(H)	Edu Cess of Customs - 2% of 'G'	2	1,125.12	1,125.12
(I)	SAH Education Cess of Customs - 1% of 'G'	1	562.56	562.56
(J)	Sub-total for Spl CVD 'C+D+E+F+H+I'		257,943.68	
(K)	Special CVD u/s 3(5) - 4% of 'J'	4	10,317.75	10,317.75
(L)	Total Duty			**68,261.43**
(M)	Total duty rounded to			68,261

Notes – Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above. A trader who sells imported goods in India aftercharging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above

An importer imported some goods for subsequent sale in India at $ 12,000 on CIF basis. Relevant exchange rate as notified by the Central Government and RBI was Rs. 45 and Rs. 45.50 respectively. The item imported attracts basic duty at 10% and education cess as applicable. If similar goods were manufactured in India, Excise Duty payable as per Tariff is 16% plus education cess of 2%. Spl CVD is payable at applicable rates. Arrive at the Assessable value and the total duty payable thereon. What are the duty refunds/benefits available if the importer is (a) manufacturer (b) service provider (c) Trader?

CIF Value	=	12,000 US $
Total CIF in Rs. @ 45.00 per US $	=	Rs. 5,40,000
Add : Landing Charges @ 1% of CIF	=	Rs. 5,400
(A) Assessable Value	=	Rs. 5,45,400

Calculation of duty payable is as follows -				
		Duty %	**Amount**	**Total Duty**
(A)	Assessable Value Rs 10,000		545,400.00	
(B)	Basic Customs Duty	10	54,540.00	54,540.00
(C)	Sub-Total for calculating CVD '(A+B)'		599,940.00	
(D)	CVD 'C' x excise duty rate	16	95,990.40	95,990.40
(E)	Education cess of excise - 2% of 'D'	2	1,919.81	1,919.81
(F)	SAH Education cess of excise - 1% of 'D'	1	959.90	959.90
(G)	Sub-total for edu cess on customs 'B+D+E+F'		153,410.11	
(H)	Edu Cess of Customs - 2% of 'G'	2	3,068.20	3,068.20
(I)	SAH Education Cess of Customs - 1% of 'G'	1	1,534.10	1,534.10
(J)	Sub-total for Spl CVD 'C+D+E+F+H+I'		703,412.41	
(K)	Special CVD u/s 3(5) - 4% of 'J'	4	28,136.50	28,136.50
(L)	Total Duty			**186,148.91**
(M)	Total duty rounded to			186,149

Notes –Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above. A trader who sells imported goods in India after charging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above.

Question - An actual user imports following goods from England per S. S. Vishal: (1) Second hand numerically controlled horizontal lathe machine - Tariff heading – 84.5811, Value FOB - 1,000/- Pound Sterling (2). A. C. motors - Tariff heading – 85.0110, Value FOB - 500/- Pound Sterling. - - Other relevant data are: - Exchange rate 1 UK Pound = Rs. 65, Freight – 150 UK Pounds, Insurance – 25 UK Pounds. - - Rate of duty : Basic customs duty - 10%, CVD - 16%, Education Cess and Spl CVD at applicable rates. - - It is found that the lathe machine is undervalued. It is proposed to load the FOB value of the lathe machine by 25%. Party does not want show cause notice and personal hearing. Compute – (i) Assessable value; (ii) Total duty payable. What are the duty refunds/benefits available if the importer is (a) manufacturer (b) service provider (c) Trader?

Answer - Since FOB value of lathe machine is being loaded by 25% for under-valuation, the FOB Value of lathe machine for purpose of assessment is 1250 UK Pounds. Value of AC Motors is 500 UK Pounds. Thus, total FOB value for purposes of customs valuation is 1,750 UK Pounds. - - Total insurance and freight is 175 UK Pounds [freight is 150 UK Pounds and insurance is 25 UK Pounds]. This will be allocated on lathe machine and AC motors in proportion to value (as no other basis is available). Thus, allocation of freight and insurance charges will be in ratio of 1250/1750 and 500/1750, i.e. 125 UK Pounds to lathe machine and 50 UK Pounds to AC motors.

Hence, CIF value of lathe machine for purpose of customs valuation is 1,375 UK Pounds (1,250 +125) i.e. Rs 89,375 (@ Rs 65 per UK Pound) and CIF value of AC motors is 550 UK Pounds (500 + 50), i.e. Rs 35,750 (@ Rs 65 per UK Pound). Assessable Value will be CIF plus landing charges

of 1%. Hence, Assessable Value of lathe is 90,269 (89,375 + 894) and AV of motors is Rs 36,107 (35,750 + 357).

Calculation of duty payable is as follows -				
		Duty %	**Amount**	**Total Duty**
(A)	Assessable Value Rs 10,000		90,269.00	
(B)	Basic Customs Duty	10	9,026.90	9,026.90
(C)	Sub-Total for calculating CVD '(A+B)'		99,295.90	
(D)	CVD 'C' x excise duty rate	16	15,887.34	15,887.34
(E)	Education cess of excise - 2% of 'D'	2	317.75	317.75
(F)	SAH Education cess of excise - 1% of 'D'	1	158.87	158.87
(G)	Sub-total for edu cess on customs 'B+D+E+F'		25,390.86	
(H)	Edu Cess of Customs - 2% of 'G'	2	507.82	507.82
(I)	SAH Education Cess of Customs - 1% of 'G'	1	253.91	253.91
(J)	Sub-total for Spl CVD 'C+D+E+F+H+I'		116,421.59	
(K)	Special CVD u/s 3(5) - 4% of 'J'	4	4,656.86	4,656.86
(L)	Total Duty			**30,809.45**
(M)	Total duty rounded to			30,809

Notes – Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above. A trader who sells imported goods in India after charging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above..

Duty on Motors – Student should himself calculate duty by using aforesaid procedure. Total customs duty payable is Rs. **12,323.57**. See if your answer tallies.

Question : **An importer has imported a machine from UK at FOB cost of 10,000 UK Pounds. Other details are as follows :**

(*a*) Freight from UK to Indian port was 700 pounds.

(*b*) Insurance was paid to insurer in India : Rs. 6,000

(*c*) Design and development charges of 2,000 UK pounds were paid to a consultancy firm in UK

(*d*) The importer also spent an amount of Rs. 50,000 in India for development work connected with the machinery.

(*e*) Rs. 10,000 were spent in transporting the machinery from Indian port to the factory of importer.

(*f*) Rate of exchange as announced by RBI was : Rs. 68.82 = one UK Pound

(*g*) Rate of exchange as announced by CBE&C (Board) by notification under section 14(3)(a)(i) : Rs. 68.70 = One UK pound

(*h*) Rate at which bank recovered the amount from importer : Rs. 68.35 = One UK Pound.

(*i*) Foreign exporters have an Agent in India. Commission is payable to the agent in Indian Rupees @ 5% of FOB price.

Customs duty payable was 10%. If similar goods were produced in India, excise duty payable as per tariff is 24%. There is an excise exemption notification which exempts the duty as is in excess of 16%. Education cess is as applicable Spl CVD is payable at applicable rates. Find customs duty payable. What are the duty refunds/benefits available if the importer is (a) manufacturer (b) service provider (c) Trader?

Answer :

FOB Value	=	10,000.00 UK Pounds
Add :Design & Development Charges	=	2,000.00 UK pounds
Add : Ocean freight	=	700.00 UK Pounds
Total C & F	=	12,700.00 UK Pounds
Total in Rs. @ 68.70	=	8,72,490.00 Rs.
Add : Insurance	=	6,000.00 Rs.
Add : Local Agency commission 500 UK pounds @ Rs. 68.70 = 1 UK Pound	=	34,350.00 Rs.
Total CIF Price	=	9,12,840.00 Rs.
Add : Landing Charges @ 1% of CIF	=	9,128.40 Rs.
Assessable Value	=	9,21,968.40 Rs.
Assessable Value (rounded to)	=	9,21.968.00 Rs.

Calculation of duty payable is as follows -				
		Duty %	**Amount**	**Total Duty**
(A)	Assessable Value Rs 10,000		921,968.00	
(B)	Basic Customs Duty	10	92,196.80	92,196.80
(C)	Sub-Total for calculating CVD '(A+B)'		1,014,164.80	
(D)	CVD 'C' x excise duty rate	16	162,266.37	162,266.37
(E)	Education cess of excise - 2% of 'D'	2	3,245.33	3,245.33
(F)	SAH Education cess of excise - 1% of 'D'	1	1,622.66	1,622.66
(G)	Sub-total for edu cess on customs 'B+D+E+F'		259,331.16	
(H)	Edu Cess of Customs - 2% of 'G'	2	5,186.62	5,186.62
(I)	SAH Education Cess of Customs - 1% of 'G'	1	2,593.31	2,593.31
(J)	Sub-total for Spl CVD 'C+D+E+F+H+I'		1,189,079.09	
(K)	Special CVD u / s 3(5) - 4% of 'J'	4	47,563.16	47,563.16
(L)	Total Duty			**314,674.25**
(M)	Total duty rounded to	Rs		314,674

Notes – Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above. A trader who sells imported goods in India after charging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above.

Note : (1) Design and development work done in India and transport costs within India are not to be considered for purposes of 'Customs Value'. (2) Excise duty rate has to be considered after considering excise exemption notification. (3) Assessable Value and Final duty payable should be rounded off to nearest Rupee.

Duty payable is same whether the importer is manufacturer or a trader.

Mrs. & Mr. Kapoor visited Germany and brought following goods while returning to India on 8th February, 2008. (i) Their personal effects like clothes, etc., valued at Rs. 35,000. (ii) A personal computer bought for Rs. 36,000. (iii) A laptop computer bought for Rs. 95,000. (iv) Two litres of liquor bought for Rs. 1,600. (v) A new camera bought for Rs. 37,400. What is the amount of customs duty payable?

Personal effects and one laptop are exempt from customs duty. Two liters of liquor can be accommodated in General free Allowance. Hence, Mr. Kapoor can bring one personal computer and two litres of liquor on his account. Total value is Rs 37,600 (PC Rs 36,000 plus liquor Rs 1,600). He will get General Free Allowance of Rs 25,000 and duty payable will be on Rs 12,600. Customs Duty @ 35% of Rs 12,600 will be Rs 4,410 plus education cess of Rs 88.20 @ 2% of customs duty and SAH education cess of Rs 44.10 @ 1% of customs duty.

Mrs. Kapoor can bring one camera on her account. Total value is Rs 37,400. She will get General Free Allowance of Rs 25,000 and duty payable will be on Rs 17,400. Customs Duty @ 35% of Rs

17,400 will be Rs 6,090 plus education cess of Rs 121.80 @ 2% of customs duty and Rs 60.90 as SAH education cess.

6.4 METHODS OF VALUATION OF IMPORTED GOODS

The Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, based on WTO Valuation Agreement (earlier GATT Valuation Code), consist of rules providing six methods of valuation.

The methods of valuation for customs methods are as follows -

- Transaction Value of Imported goods [Section 14(1) and Rule 3(1)]
- Transaction Value of Identical Goods [Rule 4]
- Transaction Value of Similar Goods [Rule 5]
- Deductive Value which is based on identical or similar ***imported*** goods sold in India [Rule 7]
- Computed value which is based on cost of manufacture of goods plus profits [Rule 8]
- Residual method based on reasonable means and data available [Rule 9]

6.4.1 Conditions for accepting Transaction Value

In *Eicher Tractors* v. *CC* 2000 AIR SCW 4080 = AIR 2001 SC 196 = 2001(1) SCC 315 = 122 ELT 321 = 41 RLT 621 (SC), it has been held that actual transaction value can be rejected only for reasons specified in rule 4(2) [Now rule 3(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 w.e.f. 10-10-2007] of Valuation Rules and 'special circumstances' or 'extraordinary circumstances' as specified in section 14(1). Subject to the three conditions laid down in section 14(1) of time, place and absence of special circumstances, price of imported goods is to be determined u / s 14(1A) in accordance with Valuation Rules framed in this behalf.

Thus, transaction value can be rejected either for special circumstances as per section 14(1) or conditions as specified in rule 3(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

Special circumstances as per section 14(1) - The 'special circumstances' in section 14(1) are (*a*) Buyer and seller should not be related ***and*** (b) Price should be the sole consideration for the sale. If these 'special circumstances' are not satisfied, transaction value can be rejected. Any other 'special circumstances' cannot be considered.

Methods to be applied sequentially - These methods are to be applied in sequential order, i.e. if method one cannot be applied, then method two comes into force and when method two also cannot be applied, method three should be used and so on. The only exception is that the 'computed value' method may be used before 'deductive value' method, if the importer requests and Assessing Officer permits.

Conditions as per rule 3(2) - As per rule 3(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [Earlier rule 4(2) of Customs Valuation Rules], transaction value can be accepted only if following requirements are satisfied –

No restriction on buyer for disposal of goods - There are no restriction on buyer on disposition or use of goods *except* the following: (*a*) restrictions prescribed by public authorities in India (*b*) restriction on geographical area within which goods may be resold e.g. goods should not be sold outside particular State or outside India *or* (*c*) restriction that does not materially affect value of goods - e.g. exporter puts a condition to importer of automobile that car should not be exhibited before a particular date – illustration given in Interpretative Note to rule 3(2)(a)(iii). [rule 3(2)(a)] [earlier rule 4(2)(e) upto 10-10-2007]

Sale not subject to conditions of which value cannot be determined - The sale or price should not be subject to a condition or consideration for which value cannot be determined. Examples given in interpretative note to rule 3(2)(b) are – (a) Price is subject to condition that buyer buys some other goods in specified quantities from seller (b) price is dependant on price at which buyer of imported goods sells other goods to seller (c) Price is based on form of payment extraneous the imported goods. However, (i) buyer furnishing engineering and plans undertaken in India to seller (ii) Buyer undertaking activities of marketing of imported goods in India will not form part of value of imported goods [rule 3(2)(b)] [earlier rule 4(2)(f) upto 10-10-2007].

No further consideration to seller of which adjustment cannot be made - Seller should not be entitled to further consideration like part of subsequent resale, disposal or use of goods by the buyer will accrue directly or indirectly to seller, unless proper adjustment in value terms can be made as per rule 10 e.g. if the importer is a trader and the condition is that after he sells the goods in India, the foreign exporter will get a fixed amount after the sale, that extra amount can be added for Customs Valuation [rule 3(2)(c)] [earlier rule 4(2)(g)]

Unrelated buyer and seller, except when price acceptable under rule 3(3) - Buyer and seller are not be related, unless the transaction value is acceptable under rule 3(3) [rule 3(2)(d)] [earlier rule 4(2)(h) upto 10-10-2007].

If any of the aforesaid requirement is not satisfied, 'transaction value' cannot be accepted for valuation purposes.

6.4.2 Illustrations of Method of Valuation

Question : An importer 'WR Importers Ltd.' imported 1,000 Kgs of 'X' goods from a manufacturer-exporter 'AB Inc.' in USA in April 2008 and presented Bill of Entry indicating value of US $ 10,000 CIF. Customs Appraiser found from his records as follows :

(*a*) AB Inc, USA had supplied 150 Kgs of 'X' to another importer in India @ 16 $ CIF per Kg in March 2008.

(*b*) Same exporter had supplied 1,200 Kgs of X to an importer in India @ 18 US $ in September 2007.

(*c*) Price of 'AB Inc' for sale of that product in USA is 20 US $ per Kg.

(*d*) Another manufacturer-exporter from USA had supplied 800 Kgs 'X1' goods to an importer in India @ 14 US $ per Kg in February 2008. The 'X1' are alike 'X' and can be used instead of 'X'. Both manufacturers-exporters from USA are well reputed.

(*e*) Similar goods produced in India are available in India at equivalent dollar price of 12 US $ per Kg.

Show cause notice was issued to importer. The importer replied that he has been able to negotiate the lower price as a special introductory price. He also produced a copy of invoice from manufacturer in Germany, who had supplied the 900 Kgs of 'X2' goods @ 10.50 US dollars per Kg in February, 2008. The 'X2' goods are equivalent to 'X' and can be used instead of 'X'.

Prepare an Order finalising the 'Customs Value' for purpose of assessment.

Answer :

Office of Assistant Commissioner of Customs, Mumbai

Order No. 34/02 dated 16th May, 2008

Note : (1) This copy is granted free of charge for the private use of the persons to whom it is issued.

(2) Any person aggrieved by this order may appeal against this order to Commissioner (Appeals), Mumbai, within sixty days from date of communication of this order. Appeal should be accompanied by this copy of order or another certified copy of this order.

Order

(1) M/s WR Importers Ltd., Mumbai filed Bill of Entry No. 2587 dated 14th April, 2008 for 1,000 Kgs of 'X' for 10,000 US $ CIF in respect of goods imported from USA. It was observed that similar goods were imported at higher rates than the rates declared by Assessee.

(2) A show cause notice dated 21st April, 2008 was served on the assessee. The assessee submitted their reply dated 26th April, 2008. A personal hearing was granted on 8th May, 2008. Representative of WR Importers Ltd., Mr. A M Majumdar attended the personal hearing. He reiterated the submissions made in their reply dated 26th April, 2008 and stated that the price as shown by them in Bill of Entry is the correct Customs Value for purpose of assessment.

(3) I find that the same exporter i.e. AB Inc, USA had supplied 150 Kgs of 'X' to another importer in India @ 16 $ CIF per Kg in March 2008. Assessee raised contention that quantity of imports in March 2008 is much less and hence the price cannot be considered, as per provisions of rule 4(1)(b) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007. The assessee contended that the department has not produced any evidence regarding discount structure offered by the foreign supplier depending on the quantity purchased. Hence, this price cannot be considered for valuation. I agree with these contentions of assessee.

(4) I find that the same exporter i.e. AB Inc, USA had supplied 1,200 Kg of X to an importer in India @ 18 US $ in September 2007. Assessee contended that price of goods imported in September 2008 cannot be considered for valuation of goods imported in April 2008 as the import is not at or about the same time, as required in rule 4(1)(a) Customs Valuation (Determination of Value of Imported Goods) Rules, 2007. Hence, this price cannot be considered for valuation. I agree with this contention of assessee.

(5) It was brought to notice of assessee that Price of 'AB Inc' for sale within USA is 20 US $ per Kg. Assessee replied that only price in International Trade can be considered for valuation purposes as per section 14 of Customs Act. I agree with this contention of assessee.

(6) Similar goods are produced in India. These are available in India at equivalent dollar price of 12 US $ per Kg. However, I observe that such price cannot be considered for assessment in terms of rule 9(2)(i) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

(7) Assessee contended that another manufacturer in Germany, has supplied the 'X2' goods @ 10.50 US dollars per Kg at around the same time. The 'X2' goods are equivalent to 'X' and can be used instead of 'X' and that price may be considered for assessment. I find that in terms of rule 5, price of similar goods can be considered only if both are from same country. The price of goods imported from Germany could have been considered under rule 9(1) as residual method. However, this method has application only if Customs Value cannot be determined by any other method.

(8) Another manufacturer-exporter from USA had supplied 800 Kgs 'X1' goods to an importer in India @ 14 US $ per Kg in February 2008. The 'X1' are alike 'X' and can be used instead of 'X'. Both manufacturers-exporters from USA are well reputed. Thus, in terms of rule 5 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, these could be considered as 'similar goods' and hence that price can be adopted for valuation.

(9) The importer in his reply stated that he has been able to negotiate the low prices of US $ 10/- as special introductory price on special consideration of assurance of future orders. However, he stated that in terms of explanation (1)(ii) to Valuation Rules, even if discount is abnormal, the declared value is required to be accepted if it is true and accurate.

(10) Assessee contended that even if the price is low, it is true and accurate. There is no evidence that the difference was paid through some different means to the exporter.

(11) I agree with the contention of the assessee.

ORDER

I order that Customs Value be fixed on the basis of CIF price of 10 US dollars per Kg. The assessment be finalised accordingly.

Sd/-Assistant Commissioner

6.5 VALUATION OF EXPORT GOODS

Customs value of export goods is to be determined under section 14 of Customs Act, read with Customs Valuation (Determination of Value of Export Goods), Rules, 2007.

Transaction value is the main criteria for valuation - Section 14(1) of Customs Act (effective from 10-10-2007) states that 'value' of imported and export goods will be 'transaction value' of such goods i.e. the price actually paid or payable for the goods when sold for export to India for delivery at the time and place of importation, or for export from India for delivery at the time and place of exportation, where the buyer and seller of the goods are not related and price is the sole consideration for the sale, subject to such other conditions as may be specified in the rules made in this behalf.

Thus, if buyer and seller are not related and if price is the sole consideration, transaction value at the time and place of exportation will be the assessable value.

Transaction value is the primary basis for valuation of export goods and the method specified in rule 3 will be applicable in the vast majority of cases of export by acceptance of declared value – par 4 of MF(DR) circular No. 37/2007-Cus dated 9-10-2007.

Rate of foreign exchange - Third *proviso* to new section 14(1) states that such price shall be calculated with reference to the rate of exchange as in force on the date on which a bill of entry is presented under section 46, or a shipping bill or bill of export, as the case may be, is presented under section 50. As per *Explanation* (a) to section 14(2), the rate of exchange will be determined by CBE&C or ascertained in such manner as CBE&C may direct.

Tariff value - section 14(2) empowers CBE&C to fix tariff values of imported goods or export goods by issuing a notification.

Valuation Rules if transaction value is not determinable - If there is no sale or buyer or seller are related or price is not the sole consideration, value of the goods will be determined as per Valuation Rules [Clause (ii) of second proviso to section 14(1)].

Valuation when buyer and seller are related – Definition of related person as per rule 2(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007 is same as per definition of rule 2(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

As per rule 3(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007, the transaction value, the transaction value will be accepted as 'value' even if buyer and seller are 'related', if the relationship has not influenced price.

Valuation if value cannot be determined on basis of transaction value – If valuation is not possible on basis of transaction value, valuation will be done by proceeding sequentially through rules 4 to 6 [Rule 3(3) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007].

The methods are - Export value by comparison [Rule 4}, Computed value [Rule 5] and Residual method [Rule 6].

6.6 SELF ASSESSMENT ON BASIS OF 'RISK MANAGEMENT SYSTEM' (RMS)

One major step is being taken to move in the direction of implementing international best practices in customs clearance. A 'Risk Management System' for customs clearance of import and export cargo has been introduced. The details of scheme are contained in MF(DR) circular No. 43/2005-Cus dated 24-11-2005 – see also CC, Bangalore-I PN 88/2006 dated 31-7-2006 (201 ELT T5).

Initially, the scheme will be introduced in Air Cargo Complex, Sahar Mumbai and then it will be introduced in other customs houses in phases.

Under Risk Management System (RMS), only high risk cargo is selected for examination. The system provides for special customs clearance for Accredited Clients having good track record and meet specified criteria.

The scheme proposes to do away with existing system of routine assessments and concurrent audit. Goods will be normally cleared on basis of self assessment of importer. Bill of Entry submitted electronically will be transmitted to RMS. The RMS will process the data and produce an electronic output. This output will determine whether the Bill of Entry will be taken up for appraisement/examination or be cleared after payment of duty without any assessment and examination. Any change is system will require prior approval of Commissioner of Customs and after recording reasons.

Focus will be on quality assessment, examination and post clearance audit of Bills of Entry selected by the Risk Concurrent audit will be replaced by Post Clearance Audit on Bill of Entry selected by the Risk Management System. Subsequently, demand can be raised even if goods have been cleared from customs.

No change in Custom Act and Rules - The scheme is being introduced without making any change in Customs Act or Rules, the basic procedures of sanctions and approvals remain unaltered and hence is not similar to scheme of self-assessment under Central Excise, where clearances are effected by assessee without supervision or presence of excise inspectors. Scope of the scheme is also very limited.

Scheme open only to 'Accredited Clients' - The scheme is limited to only 'Accredited Clients' as defined in MF(DR) circular No. 42/2005-Cus dated 24-11-2005. They should have imported goods valued at Rs 10 crores in previous financial year or paid duty more than Rs one crore. In case of importers who are central excise, they should have paid at least Rs one crore of duty

through PLA in previous financial year. They should have filed at least 25 Bills of Entry in the previous financial year.

Person who had received any show cause notice in last three financial years is ineligible - In order to ensure that scope of the scheme remains limited (and the scheme fails), it is provided that no case should be pending against them. Even show cause notice invoking penal provisions should not have been issued against them is last three financial years. Such importers can be probably counted on fingers. If this condition is insisted upon, the scheme is stillborn and will be a non-starter.

Application for getting accreditation - Importers desirous of availing the facility of 'Accredited Client' has to make application for registration in form given in MF(DR) circular No. 42/2005-Cus dated 24-11-2005. Application has to be accompanied by a CA certificate that the accounting system of applicant is as per accounting standards prescribed by ICAI.

Decision regarding ACP status within 30 days - In case of status holders, Customs will communicate decision on conferring ACP status (Accredited Client under Risk Management System of customs clearance, within 30 days from receipt of application by customs.

Risk management division in systems directorate – A risk management division has been created in Systems Directorate. Risk Management Committees will be constituted at National level and Local level – MF(DR) circular No. 23/2007-Cus dated 28-6-2007.

STUDY NOTE - 7

BASICS OF SERVICE TAX

This Study Note includes

- Introduction
- Value of Taxable Service
- Exemption from Service Tax
- Classification of Service
- Procedures of Service Tax
- Adjudication and Appeals
- Export of Services
- Import of Services

7.1 INTRODUCTION

Service tax is tax of 21st Century. In India share of GDP in 2006-07 was - Agriculture - 18.5%, Industry - 26.4%, Services - 55.1% (Source - Economic Survey 2006-07). Service tax was imposed on three services w.e.f. 1-7-1994 and its scope is being widened every year. Highlights of the service tax are as follows –

- Service tax is imposed under Finance Act, 1994 as amended from time to time. There is no Service Tax Act.
- Service tax is payable @ 12% plus education cess of 2%, plus SAH education cess of 1% (total 12.36%) w.e.f. 11th May 2007 [Section 66]. Service tax was 12.24% from 18-4-2006 to 10-5-2007. Earlier, the rate was 10.2% from 10-9-2004 to 17-4-2006.
- Service tax is payable on taxable services as defined in various clauses of section 65(105) of Finance Act, 1994. Presently, about 99 services are taxable.
- Service tax is payable on gross amount charged for taxable service provided or to be provided [Section 67]. If consideration is partly not in money, valuation is required to be done as per Valuation Rules. Tax is payable when advance is received.
- Small service providers upto eight lakhs are exempt. Export of service is exempt from service tax under Notification No. 6/2005-ST dated 1-3-2005. Services provided in J&K are not taxable [section 64(1)]
- Cenvat credit is available of inputs, input services and capital goods used for providing taxable output services.
- In some cases, receiver of service is liable to pay service tax. This is termed as 'reverse charge' [Section 68(2)].

- Every provider of taxable service should apply for registration in form ST-1 within 30 days from date of levy (in case of new services) and date of commencement of business of providing taxable service In case of existing services [Rule 4(1)]. Registration will be deemed to have been granted if not received within seven days [Rule 4(5)].
- Assessee providing service from various premises can have centralised registration [Rule 4(2)]
- Service provider is required to prepare invoice within 14 days, even in respect of advance received [Rule 4A].
- Tax should be paid by 5th of following month (6^{th} in case of e-payment). If assessee is individual or proprietary or partnership firm, tax is payable on quarterly basis. This facility is not available to HUF. In March, tax is payable by 31st March [Rule 6].
- If payment of tax is delayed, interest is payable @ 13% [Section 75]
- Assessee has to submit half yearly return in form ST-3 in triplicate within 25 days of close of half year [Rule 7]
- Penalty is payable for non-registration, late payment of tax, non-submission of returns etc. Mandatory penalty is payable for suppression of facts, willful misstatement, fraud or collusion [sections 76 to 80]
- The tax is administered by excise department. Adjudication order is issued by excise officer.
- First appeal lies with Commissioner (Appeals) [section 85] and second appeal with Appellate Tribunal (Customs, Excise and Service Tax Appellate Tribunal) [Section 86]. Further appeal lies with High Court and Supreme Court.

Nature of levy of Service Tax - Service tax is levied under Entry No. 97 of List I of Seventh Schedule to Constitution of India. The entry reads as follows – 'Any other matter not included in List II, List III and any tax not mentioned in list II or list III'. *(These are called 'Residual Powers'.)*

As per section 65(95) of Finance Act, 1994, 'service tax' means tax leviable under the provisions of this Chapter (i.e. Chapter V of Finance Act, 1994). Section 66 (charging section) provides that there shall be levied a tax (service tax) @ 12% of the value of taxable service referred to in various clauses of section 65(105). It will be collected in a manner as may be prescribed.

Taxable Service **-** As per section 66 of Finance Act, 1994, service tax is payable on 'taxable service'. Various clauses of section 65(105) of Finance Act, 1994 define each type of 'taxable service'. The definition is different for each class of services, e.g. as per section 65(105)(a), any service provided by stock broker to any person in connection with sale or purchase of securities listed on a recognised stock exchange will be 'taxable service'.

Service tax is destination-based consumption tax - Service tax is a destination based consumption tax, as per CBE&C Circular No. 56/5/2003 dated 25-4-2003.

Service implies existence of two parties - Service tax is attracted when there are two parties. One cannot give service to himself.

Cenvat Credit – Assessee is entitled to avail Cenvat credit of excise duty and service tax paid on his inputs, input services and capital goods. This aspect has been discussed in another chapter.

Rate of Service Tax

This tax was first time introduced with effect from 1-7-1994 on three services. The rate was 5%. It was subsequently increased to 8% w.e.f. 14-5-2003. It was 10% plus education cess of 2% w.e.f. 10-9-2004 (total 10.2%) during 10-9-2004 to 17-4-2006. Service tax rate was 12% plus education cess of 2% (total 12.24%) during 18-4-2006 till 10-5-2007.

Presently (w.e.f. 11-5-2007), service tax is payable @ 12% of value of taxable services referred in section 65(105) of Finance Act, 1994. In addition, education cess of 2% and SAH education cess of 1% is payable. Thus, total service tax is 12.36%.

Service tax, education cess and SAH education cess to be shown separately in invoice - You have to show service tax, education cess and SAH education cess *separately* in invoice. You cannot just charge 12.36% as 'service tax'.

Taxable Event in Service Tax

Section 66 (which is a charging section), reads, 'There shall be levied a tax (hereinafter referred to as the service tax) at the rate of ten percent of value of taxable services referred to in sub-clauses (a), (b), - - - (zzzzc) and (zzzzd) of clause (105) of section 65 and collected in such manner as may be prescribed.

Opening sentence of section 65(105) as amended w.e.f. 16-6-2005 reads as follows, 'taxable service' means any service provided or 'to be provided'. Thus, following are taxable events -

(*a*) *Entering into contract for service* - Entering into contract for providing service. Once you enter into a contract, it is certainly '*service to be provided*'. (Service tax is actually payable after payment is received, but receipt of advance is not a taxable event. It only defers the liability).

(*b*) *Provision of service* - This will happen in cases where contract for providing service was entered into *before* the service became taxable, but service was provided *after* the service became a 'taxable service'.

Person liable to pay Service tax

In most of the cases, service provider, i.e. person who is providing taxable service is liable to pay service tax. However, in few cases, exceptions have been made and service receiver is made liable to pay service tax. The provision that service receiver is liable to pay service tax is termed as 'Reverse Charge'. The exceptions are as follows -

Services provided to non-resident - In relation to taxable service provided or to be provided by any person from a country other than India and received by any person under section 66A of Finance Act, service tax is payable by recipient of service [Rule 2(1)(d)(iv)]

Services of insurance agents - In case of insurance auxiliary service by an insurance agent, the tax will be payable by insurance company (general insurance or life insurance as the case may be). The insurance agent is not liable to register and pay tax. [*However, the insurance agent is not entitled to avail exemption available to a small service provider*].

Consignor/consignee paying freight, in case of GTA services - In case of services of Goods Transport Agency (GTA), service tax is payable by consignor / consignee who is paying freight [rule 2(1)(d)(v)] [*However, the consignor/consignee is not entitled to avail exemption available to a small service provider*].

Services of Agents of mutual fund - In case of distributors / agents of mutual funds, the liability will be on the recipient of service, namely, mutual funds [Rule 2(1)(vi)] [*However, the mutual fund agent is not entitled to avail exemption available to a small service provider*].

Body corporate or firm located in India receiving sponsorship service - In case of sponsorship service provided to a body corporate or firm located in India, the body corporate or firm receiving such sponsorship service will be liable to pay service tax [rule 2(1)(d)(vii) inserted w.e.f. 1-5-2006 and amended w.e.f. 1-4-2007]. If the recipient of sponsorship service is located outside India, service tax is required to be paid by the service provider and not by the recipient.

Cenvat credit of tax paid - The Body corporate or firm paying such service tax will be eligible to avail Cenvat credit of the service tax paid, on the basis of TR-6 / GAR-7 challan by which the tax is paid [Rule 9(1)(e) of Cenvat Credit Rules, as amended w.e.f. 1-5-2006]. *It may be noted that when person receiving service is liable to pay service tax, he is not entitled to exemption which is available to a small service provider*.

Large Taxpayer Unit (LTU) - A concept of LTU has been introduced for large taxpayers of direct taxes and indirect taxes. In case of service tax, Large Taxpayer has meaning assigned to it in Central Excise Rules [rule 2(cccc) of Service Tax Rules]. LTU has started functioning in Bangalore w.e.f. 1-10-2006.

Service on sub-contract basis

CBE&C vide circular No. 999.03 / 23.8.07 has clarified that a sub-contractor is also a taxable service provider. His services are taxable even if these are used by main provider for completion of his work. The sub-contractor is liable even if the service is input service of the main contractor and main contractor is paying service tax on entire value of contract.

7.2 VALUE OF TAXABLE SERVICE

Section 67 of Finance Act, 1994 contains provisions for valuation of taxable services for charging service tax. The highlights of provisions of section 67 as effective from 18-4-2006 are as follows -

- Service tax is payable on gross amount charged by service provider for service provided or 'to be provided'. Thus, tax is payable as soon as advance is received.

- 'Value of taxable service' plus service tax payable is equal to 'gross amount charged' [section 67(2)].

- Where the consideration for providing services is entirely in money, gross amount charged by service provider of taxable service provided or to be provided by him will be relevant for 'valuation' [section 67(1)(i)].

- Where the consideration for providing services is not wholly or partly in terms of money, service tax is payable on amount of money, which with addition of tax service tax charged, is equivalent to the consideration [section 67(1)(ii)].

- Where consideration is not ascertainable, valuation will be on basis of Valuation Rules [section 67(1)(iii)]

- If gross amount charged by service provider is inclusive of service tax (i.e. service tax not charged separately in invoice), value of taxable service will be calculated by back calculations such that with addition of service tax payable, the total is equal to the gross amount charged [section 67(2)].

- Gross amount charged for taxable services can be before, during or after provision of service [section 67(3)].

Highlights of service tax valuation rules - In exercise of powers under section 67, Service tax (Determination of Value) Rules, 2006 have been issued w.e.f. 19-4-2006. The Service Tax Valuation Rules provide as follows -

- If consideration is not wholly or partly consisting of money, value will be determined by service provider in terms of rule 3.

- As per rule 3(a) of Service Tax Valuation Rules, valuation shall be on basis of gross amount charged by service provider for similar services.

- If value cannot be determined on basis of rule 3(a), valuation shall be on basis of equivalent money value of such consideration, which shall not be less than cost of provision of such services [rule 3(b) of Service Tax Valuation Rules]

- Central Excise Officer can reject 'value' determined by service provider and determine 'value' for purpose of service tax payment [rule 4].

- Rules 5 and 6 make provisions for certain specific inclusions and exclusions for valuation

- Payments made by service provider as 'pure agent' of service receiver and recovered from service receiver are excluded for purpose of valuation [rule 5(2)]
- In case of services provided from outside India, actual consideration received will be relevant for valuation [rule 7(1)].

Amount need not be 'charged' by service provider - money paid to third party may also be includible - It is not necessary that the money should be paid to service provider himself. Amount paid even to third party is includible in 'value' of service if it is for provision of service and at the instance of service provider.

Service tax payable on net amount excluding Vat/sales tax - Rule 2A(1)(i)(a) of Service Tax Valuation Rules and rule 3(1) of Works contract (Composition Scheme for Payment of Service Tax) Rules, 2007 make it clear that Vat / sales tax is not to be included in value for purpose of service tax. Thus, service tax is payable only on net amount excluding Vat / sales tax payable on the transaction.

Tax payable only on amount actually received - Rule 6(1) of Service Tax Rules makes it clear that service tax is payable on value of taxable services received. Thus, if service provider does not receive any payment from his customer, there is no liability of service tax. Service tax is payable only on 'value of taxable service' actually '*received*', and not on amount '*billed*'.

Calculation of service tax by back calculations

The gross amount charged can be taken as inclusive of service tax and the 'value' and 'service' tax is to be calculated by back calculations.

For example, if Bill amount is Rs. 1,000 and service tax is not shown separately in Invoice, the tax payable calculated by a simple mathematical formula is as follows -

Assessable Value = (Cum tax price) / (1 + rate of tax)

Assume that Assessable Value (AV) is equal to 'Z'.

AV	=	1.000 Z
Duty @ 12.36%	=	0.1236 × Z
Sub-Total	=	1.1236 × Z
Now :		
1.1236 × Z	=	1,000
Hence, 'Z'	=	1,000 / 1.1236
i.e. Z	=	890.00

Thus, 'Z', i.e. Assessable Value is Rs 890 and service tax @ 12% will be Rs 106.79. Education cess @ 2% of service tax will be Rs 2.14. SAH education cess is Rs 1.07. Thus, total tax will be Rs 110.00.

Reimbursement of expenses or 'Out of pocket' expenses

The service provider often claims reimbursement of certain expenses incurred by him (like travelling, boarding and lodging, etc.) while providing a taxable service. These are often termed as 'out of pocket' expenses. These are really charges for taxable services and are includible.

Reimbursement of expenses incurred on behalf of service receiver not includible - Often, a service provider incurs some expenditure on behalf of service receiver and then recovers the amount from him. Such expenditure is not part of service provided by him to service receiver, but is incurred by him as per business practice or convenience. Following illustrations may clarify the provisions -

- Octroi / entry tax amount paid by Clearing & Forwarding Agent, CHA or Transporter on behalf of owner of goods / Principal.
- Customs duty, dock dues, demurrage, transport charges etc. paid by Customs House Agent on behalf of client.
- Advertisement charges paid by Advertising Agency to newspaper on behalf of clients.
- Ticket charges paid by Travel Agent and recovered from his customer.
- Reimbursement of godown, salary and loading / unloading expenses by Principal to C&F Agent.

These are not part of service provided and hence are not includible. Rule 5(2) provides that the expenditure or costs that a service provider incurs, as a pure agent of the client, shall be excluded from the value if such service provider fulfils prescribed conditions.

The principle is also discernible from various exclusions as contained in rule 6(2).

Valuation in case of indivisible contracts

In case of indivisible contracts involving sale of goods plus provision of service, it is difficult to identify service portion.

Exclusion of value of material - Notification No. 12 / 2003-ST dated 20-6-2003 provides that if the amount charged includes value of goods and materials sold, service tax will not be payable on value of goods and materials sold. There should be documentary evidence showing value of goods and materials sold. This exemption is available *only if* Cenvat credit of such material is not taken. If such credit was taken, assessee should pay amount equal to the credit. Such payment should be before sale of such goods and materials.

Many exemption notifications provide that exclusion under notification 12/2003-ST is allowable only when the service tax is paid at full rate and any abatement under any other exemption notification is not claimed. Hence, in such cases, notification No. 12/2003-ST is of no use.

In *Bharat Sanchar Nigam Ltd.* v. *UOI* (2006) 3 SCC 1 = 152 Taxman 135 = 282 ITR 273 = 3 VST 95 = 145 STC 91 = 3 STT 245 = AIR 2006 SC 1383 = 2 STR 161 (SC 3 member bench), it has been clearly held that price of goods cannot be included in value of services. Conclusion (E) of the judgment (para 92 of SCC and para 81 of STT and Taxman) reads as follows, 'The aspect theory would not apply to enable the value of service to be included in the sale of goods or the price of goods in the value of service'.

All expenditure and costs relating to provision of service incurred by service provider are includible - Rule 5(1) provides that where certain expenditure or costs are incurred by the service provider in the course of providing any taxable service, all such expenditure or costs shall be treated as consideration for the taxable services provided or to be provided and shall be included in the 'value' for purpose of charging of service tax on the said service.

This is a general rule which makes it clear that, even when such expenditure or costs are recovered separately by service provider from service receiver, such expenditure or costs must be included in the value of taxable service.

However, expenditure incurred by service provider as 'pure agent' of service receiver is not includible, as per rule 5(2).

7.3 EXEMPTIONS FROM SERVICE TAX

Central Government can grant partial or total exemption, by issuing an 'exemption notification' u/s 93 of Finance Act, 1994. Such exemption may be partial or total. Exemption may be conditional or unconditional. The only limitation is that exemption cannot be granted by Central Government with retrospective effect. There are following general exemptions -

Small service providers - Small units whose turnover less than Rs. ten lakhs per annum are exempt from service tax. Provisions are discussed a little later (The exemption limit was Rs four lakhs upto 31-3-2007).

Export of Services - There is no service tax on export of services, if service is exported as per 'Export of Service Rules'.

Services to UN Agencies - Services provided to UN and International Agencies are exempt [Notification No. 16/2002-ST dated 2-8-2002].

Services provided within SEZ - Services provided to SEZ unit or SEZ developer for consumption within SEZ are exempt [Notification No. 4/2004-ST dated 31-3-2004 in respect of SEZ]. The wording of notification is such that services consumed within the zone are alone exempt. Thus services provided outside SEZ (e.g. customs clearance, transport etc.) are *not* exempt.

Taxable services provided to a developer or a unit in SEZ are exempt from service tax [section 26(1)(e) of SEZ Act]. [rule 31 to SEZ Rules]

Services provided to foreign diplomatic missions, family members of diplomatic missions etc. **- Any taxable service provided to foreign diplomatic mission or consular post in India is exempt vide Notification No. 33/2007-ST dated 23-5-2007. Similarly, any taxable service provided for private use of family members of diplomatic agents or career consular offices posted in a foreign diplomatic mission or consular post in India is exempt vide Notification No. 34/ 2007-ST dated 23-5-2007.**

Services provided by RBI exempt - Exemption from service tax has been provided to all taxable services provided by Reserve Bank of India. Services where RBI is liable to pay service tax are also exempt (Notification No. 22/2006-ST dated 31-5-2006 – earlier Notification No. 7/2006-ST dated 1.3.2006).

General Exemption to small service providers

The small service providers whose turnover of taxable services from one or more premises did not exceed Rs. ten lakhs in 2007-08 will be exempt from service tax in next financial year i.e. in 2008-09 upto the turnover of Rs. ten lakhs. The provisions are prescribed in Notification No. 6/ 2005-ST dated 1-3-2005 (The exemption limit was Rs four lakhs upto 31-3-2007). However, if value of taxable turnover exceeds Rs 10 lakhs in 2008-09, there will be not exemption at all in 2009-10.

For the purpose of determining eligibility in current year, what is relevant is that 'aggregate value of taxable services *rendered*' in previous financial year should not exceed Rs. ten lakhs, while for purpose of exemption upto first-Rs. ten lakhs in current year, service tax is exempt to the extent of 'aggregate value not exceeding ten lakhs', i.e. the sum total of first *consecutive payments received* during the current financial year.

The exemption to small service providers is available subject to following conditions -

- The provider of taxable service shall not avail the CENVAT credit of service tax paid on any input services.
- Where a taxable service provider provides one or more taxable services from one or more premises, the exemption under this notification shall apply to the aggregate value of all such taxable services and from all such premises and not separately for each premises or each services.
- The taxable services provided by a person under a brand name or trade name, whether registered or not, of another person; will not be eligible for exemption available to small service providers.
- Person providing taxable service in excess of Rs. nine lakhs per annum (but less than Rs. ten lakhs) will have to register with Superintendent of Central Excise under Service Tax

provisions [Notification No. 26/2005-ST dated 7-6-2005], though they will be eligible for exemption if turnover is less than Rs. ten lakhs per annum.

Specific Exemptions

In case of some services e.g. catering services, mandap keeper services and construction services, service tax is payable at lower rates, i.e. partial abatement is available from gross value, vide 1/2006-ST dated 1-3-2006. The lower rate is applicable if the service provider does not avail Cenvat credit of duty/tax on inputs, input services and capital goods. *Till 28-2-2006, he was entitled to avail Cenvat credit on input services.* W.e.f. 1-3-2006, he cannot avail any Cenvat credit, if he avails the partial abatement.

Some important exemptions are as follows –

Taxable Service	Partial abatement available
Accommodation booking service by tour operator	10% of gross amount charged
Air Travel Agent	Option to pay service tax at flat rate on 'basic fare' @ 0.6% in case of domestic booking and 1.2% in case of international booking [rule 6(7) of Cenvat Credit Rules]
Business Auxiliary Service in relation to processing of parts and accessories used in manufacture of cycle, cycle rickshaws and hand operated sewing machines	Tax on 70% of gross amount if gross amount is inclusive of cost of inputs and input services, whether or not supplied by the client (*Is it exemption or punishment*?)
Erection, Commissioning and installation contract for supply of plant, machinery, equipment or structures plus erection, commissioning and installation services	Tax on 33% of gross amount if gross amount includes value of material
Construction Service	Tax on 33% of gross amount if gross amount includes value of material
Goods Transport Agency (GTA)	Tax only on 25% amount in his invoice [Payment will be made by consignor/consignee who is actually paying freight]
Mandap keeper, hotels and convention services, providing full catering services	Tax on 60% gross amount charged

Outdoor caterer	Tax on 50% amount if he provides full and substantial meal
Pandal and shamiana Service	70% of gross amount charged if full catering service provided
Rent-a-cab operator	Tax payable on 40% of gross amount charged
Tour operator - Package tours ("package tour" means a tour wherein transportation, accommodation for stay, food, tourist guide, entry to monuments and other similar services in relation to tour are provided by the tour operator as part of the package tour to the person undertaking the tour).	Tax is payable only on 25% of gross amount charged w.e.f. 23-8-2007 (till 22-8-2007, tax was payable on 40% of gross amount
Tour operator - providing services solely of arranging or booking accommodation for any person in relation to a tour (If Bill includes cost of accommodation)	Tax is payable only on 10% of gross amount charged
Tour operator – Other than package tours and other than service of booking accommodation where Bill includes cost of accommodation	Tax is payable only on 10% of gross amount charged
Transport of goods in container by rail	Tax payable on 30% of gross amount charged

Services provided to EOU - Services provided to EOU / EHTP / STP / BTP are ***not*** exempt from service tax. Para 6.11(c)(v) of Foreign Trade Policy (as amended on 7-4-2006) states that EOU / EHTP / STP / BTP units can avail Cenvat credit of service tax paid. The EOU units can claim rebate of service tax paid on their input services vide rule 5 of Cenvat Credit Rules (as amended on 14-3-2006). Procedure for claiming refund of service tax paid on input services and excise duty on inputs has been specified in notification No. 5 / 2006-CE(NT) dated 14-3-2006.

No service tax on service provided in J&K - Service tax provisions are not applicable in Jammu and Kashmir. Service tax will not be payable only if service is provided in J&K. If a person from J&K provides service outside J&K in any other part of India, that service will be taxable, as location where service is provided is relevant. Merely because office is situated in J&K does not mean that service is provided in J&K.

7.4 CLASSIFICATION OF SERVICE

There are various types of services on which service tax is payable. These are specified in various sub-clauses of section 65(105) of Finance Act, 1994. It is possible that a service may appear to be classifiable under more than one headings. It is necessary to specify the heading under which the service being provided is falling. This is termed as 'classification'. As per rule 4A(1) of Service Tax Rules, the invoice should indicate description and classification of service.

Principles of classification - The classification of services will be determined according to terms specified in various sub-clauses of section 65(105). [section 65A(1)]. If *prima facie*, a taxable service is classifiable under two or more sub-clauses of section 65(105), classification shall be effected as per following rules -

- The sub-clause which provides most specific description should be preferred over sub-clauses providing a more general description [section 65A(2)(a)]
- Classification should be as per essential character in case of composite services. Composite services are those consisting of combination of different services. In case of such services, if the service cannot be classified on the basis of specific description as per section 65A(2)(a) above, it shall be classified as if they consisted of a service which gives them their essential character [section 65A(2)(b)].
- Service which appears earlier in list, if service cannot be classified on above basis. If a service cannot be classified on basis of above provisions, the service should be classified under sub-clause which occurs first among the sub-clauses which equally merit consideration [section 65A(2)(c)].

Service which has been specifically excluded in definition of one service cannot be covered under another head - In *Dr. Lal Path Lab (P) Ltd.* v. *CCE* (2006) 5 STT 171 (CESTAT), it was held when there is a specific entry for an item in the tax code, same cannot be taxed under any other entry. If a service has been specifically excluded from definition of one service, it cannot be covered under another taxable service.

Introduction of new heading means earlier it was not taxable - In *Glaxo Smithkline Pharmaceuticals* v. *CCE* (2005) 1 STT 37 (CESTAT), it has been held that when an existing tariff definition remains same, introduction of new tariff entry would imply that the coverage under new Tariff was not covered by the earlier entry. When new category is introduced, it means that the service was not taxable under old category.

Service should be mainly or principally a taxable service - A composite contract cannot be vivisected and service portion cannot be subjected to tax – *Widia GMBH* v. *CCE* (2006) 5 STT 414 (CESTAT) * *Blue Star* v. *CCE* (2007) 7 STT 68 (CESTAT). In *Daelim Industrial Co.* v. *CCE* 2003 STT 438 = 7 STT 184 (CEGAT), it was held that a works contract cannot be vivisected and part of it subjected to tax.

7.5 PROCEDURES OF SERVICE TAX

Administration of service tax is under Central Excise department. The main procedures to be followed are - (a) Registration (b) Maintenance of records (c) Payment of service tax and (d) Half yearly return. There are no prescribed form of records. The records maintained by assessee including computerised data maintained by assessee in accordance with various other laws are acceptable [rule 5(1)].

Registration under Service Tax

A 'person liable for paying service tax' has to register with Superintendent of Central Excise under whose jurisdiction your premises fall. He should register within 30 days from date of commencement of the business of providing taxable service. The person will have to apply for registration in form ST-1. If a person is providing more than one taxable service, he may make a single application. He should mention in the application all the taxable services provided by him. [rule 4(4)].

Applicant should submit following at the time of filing application for registration - (a) copy of PAN (b) proof of residence and (c) constitution of applicant. If application is signed by authorised person, power of attorney would be required.

Most important document that is required is copy of Income Tax PAN number. Copy of memorandum of association or partnership deed and a list of partners / directors should be submitted.

The registration certificate will be granted by Superintendent of Central Excise in seven days in form ST-2.

STC code i.e. registration number - Registration No., also known as 'Service Tax Code (STC)' is a fifteen digit PAN based number. First 10 digits of this number are the same as the PAN of such person. Next two digits are 'ST'. Next three digits are serial numbers indicating the number of registrations taken by the service taxpayer against a common PAN – para 2.6 of CBE&C Circular No. 97/8/2007-ST dated 23-8-2007.

Premises code - The registration certificate gives details of 'premises code' which is given on the basis of Commissionerate + Division + Range + Serial No. The number is given in the registration certificate ST-2 at Sl No. 5. This number is used for easy identification of location of registration of tax payer – para 2.6 of CBE&C Circular No. 97/8/2007-ST dated 23-8-2007.

Changes to be informed in form ST-1within 30 days - Rule 4(5A) is inserted w.e.f. 1-3-2006 provides that if there is any change in information and details submitted in form ST-1 at the time of registration, the same should be informed to jurisdictional AC/DC within thirty days of such changes. The form ST-1 is both for new registration as well as amendment to existing registration certificate.

Cancellation/surrender of registration - If the assessee ceases to carry on the activity for which he is registered, he should surrender the registration certificate to the Superintendent of Central Excise [Rule 4(7)].

Assessee should file up-to-date returns and apply for cancellation. Registration may not be cancelled if any demands are pending.

Centralised Registration - In some cases, a person liable for paying service tax on a taxable service - (i) provides *such* service from more than one premises or offices (e.g. providing banking service or maintenance service from various branches/offices); *or* (ii) receives *such* service in more than one premises or offices (e.g. GTA services, sponsorship services provided to body corporate or firm located in India, mutual fund agent's service, insurance agent's service etc. where he is liable under reverse charge method); *or*, (iii) is having more than one premises or offices, which are engaged in relation to *such* service in any other manner, making such person liable for paying service tax (e.g. import of services where person receiving service is liable u/s 66A).

In such cases, such person can obtain Centralised Registration***, at his option,*** if (a) he has centralised billing system or centralised accounting system in respect of such service, *and* (b) such centralised billing or centralised accounting systems are located in one or more premises.

He can register such premises or offices from where centralised billing or centralised accounting systems are located [Rule 4(2) as amended w.e.f. 2-11-2006].

More than one centralised registration of regional/zonal offices at various places is permissible as per MF(DR) circular No. B1/6/2005-TRU dated 27-7-2005 – confirmed in para 2.5 of CBE&C Circular No. 97/8/2007-ST dated 23-8-2007.

Centralised Registration will be granted by Commissioner in whose jurisdiction the premises or offices, from where centralised billing or accounting is done, are located [rule 4(3) as amended w.e.f. 2-11-2006].

Invoice by service provider

Assessee should prepare invoice in respect of his services. The Invoice should be prepared

within 14 days from date of completion of taxable service or receipt of payment towards the value of taxable service, whichever is earlier.

Details required to be shown in invoice/bill/challan - As per rule 4A(1), the invoice / challan / Bill should be signed by authorised person of provider of input services, should be serially numbered and should contain following details -

(1) Name, address and registration number of person providing taxable service

(2) Name and address of person receiving taxable service

(3) Description, classification and value of taxable service provided or to be provided and

(4) Service tax payable on the taxable service

The rule does not make mention of date, but actually, date should be mentioned.

Education cess and SAH education cess to be shown separately - Education cess and SAH education cess to be shown separately in the Invoice for complying with requirements of Cenvat Credit Rules to facilitate availment of Cenvat credit by recipient – para 5.1 CBE&C Circular No. 97 / 8 / 2007-ST dated 23-8-2007.

Relaxation in case of banking and financial services - In case of banking and financial services provided by banking company, FI, NBFC or a commercial concern, the invoice / challan need not be serially numbered and name and address of person receiving taxable service need not be contained on the invoice / challan [*proviso* to rule 4A(1) of Service Tax Rules]. This facility is also available to input service distributors of such type of service providers – para 5.3 of CBE&C Circular No. 97 / 8 / 2007-ST dated 23-8-2007.

Invoice in case of continuous service - In some cases, service is provided continuously for successive periods of time and value of such taxable service is determined or payable periodically. In such cases, the Invoice or challan shall be issued within 14 days from last date of the period [second proviso to rule 4A(1) of Service Tax Rules amended w.e.f. 16-6-2005].

Service like telephones or Annual Maintenance Services are provided on continuous basis. Billing is done periodically (usually monthly). In such case, invoice should be made within 14 days from close that period.

Invoice at end of billing period - In case of some services like services of commission agent, it is impractical to prepare invoice of commission for each sale. Billing is done at end of the agreed period (say month or quarter), which is termed as 'Billing Period'. In such cases, it can be argued that such services are provided on continuous basis and Billing at end of the period should be acceptable.

Rounding up of tax in each invoice not required – Section 37D of Central Excise Act, which is also made applicable to service tax, requires rounding up of tax. However, this is only while making monthly / quarterly payment to Government. Rounding up of duty in each Invoice is not envisaged in section 37D of Central Excise Act.

Advance payment from customers - After 13th May 2005, service tax will be payable as soon as advance is received, even if service is provided later. Thus, service tax is payable when advance is received. Invoice will have to be prepared.

Payment of tax

A person liable to pay tax shall pay the same in prescribed manner [section 68(1)]. The service tax is payable 5th (6th in case of e-payment) of the month following the month in which payments are received toward value of taxable services *except in March* [rule 6(1) of Service Tax Rules].

If the assessee is an individual or proprietary firm or partnership firm, the tax is payable on quarterly basis within 5 days (within 6 days if e-payment is made) at the end of quarter *except in March.* (rule 6). This facility is not available to HUF firm in view of clear wording of the provision.

Exception in March - Exception has been made in case of March. Service tax on value of taxable services received during month of March or quarter of March is required to be paid by 31st March.

Assessee may find it difficult to accurately estimate the amounts he is going to receive from his customers in last two days. Hence, he may pay excess amount upto Rs 50,000; which can be adjusted in subsequent month / quarter, as per rule 6(4B) inserted w.e.f. 1-3-2007.

Payment of tax on amounts actually received - Rule 6(1) makes it clear that the liability is to pay service tax on payments towards value taxable services actually received. Thus, service tax is not payable on amounts charged in the bills / invoice, but on amounts actually received.

Self Adjustment of excess tax paid in earlier period

Facility of self-adjustment of excess service tax paid has been allowed to all assessees vide rule 6(4A) subject to the following conditions prescribed in rule 6(4B) of Service Tax Rules inserted w.e.f. 1-3-2007.

Self adjustment only in case of reasons like calculation mistake, exact amount not known etc. - Self-adjustment of excess credit is *not* allowed on account of reasons like interpretation of law, taxability, classification, valuation or applicability of any exemption notification[rule 6(4B)(i)]. In such cases, refund application should be filed and self adjustment is not permissible.

Thus, self adjustment is possible only in cases like – (a) Excess payment since exact amount to be paid could not be calculated (b) when tax is to be paid by 31st March and calculation of exact amount is practically impossible (c) calculation mistakes.

Adjustment upto Rs 1,00,000 only permissible - Excess amount paid and proposed to be adjusted should not exceed Rs. 1,00,000 for the relevant month or quarter [rule 6(4B)(iii)].

Adjustment in subsequent month/quarter - Adjustment can be made in the succeeding month or quarter [rule 6(4A)] [Rule does not say that adjustment can be made in subsequent month or

quarter *only*. As per section 13 of General Clauses Act, unless there is anything repugnant to the subject or context, the word singular includes plural and vice versa. Hence, it can be argued that adjustment can be made in any subsequent month/s or quarter/s].

Inform details of adjustment within 15 days - The details of self-adjustment should be intimated to the Superintendent of Central Excise within a period of 15 days from the date of adjustment [rule 6(4B)(iv)] [[It can be argued that this is directory provision and not mandatory provision, since in many cases, it is impossible to inform in 15 days. In such cases, information at the time of filing return should be sufficient].

Adjustment in case of service tax on renting of immovable property - In case of service tax on renting of immovable property, abatement is available in case of property tax paid to local authorities. If such tax is paid at a later date, self-adjustment in service tax payable is permissible within one year from date of payment of tax, without any monetary limit. Assessee should inform Superintendent within 15 days of making adjustment [rule 6(4C) of Service tax Rules].

Assessees having centralized registration - Assessees who have centralised registration can adjust the excess service tax paid on their own without any monetary limit provided the excess amount paid is on account of delayed receipt of details of payments from branch offices [rule 6(4B)(ii)].

Adjustment if service not provided partly or fully - If excess tax is paid, in respect of service which is not provided either wholly or partly for any reason, the excess service tax paid can be adjusted against service tax payable for subsequent period, if the value of services and tax thereon is refunded to the person from whom it was received. [rule 6(3)]. *Such adjustment is permissible only when refund is on account of services not provided.* Thus, if the person refunds on account of giving some discount to client, this provision does not apply.

Payment of service tax

The service tax is payable 5th of the month following the month (6th in case of e-payment) in which payments are received toward value of taxable services [rule 6(1) of Service Tax Rules]. Thus, service tax is *not* payable on basis of amounts charged in the bills/invoice, but only on amounts *actually received* during the relevant period.

Payment from Cenvat credit plus/GAR-7 - Assessee should first utilise Cenvat credit available. Balance amount is payable in cash.

Account code - The tax is payable by a GAR-7 Challan in the bank where excise duty is accepted in that Commissionerate. The major account head is '044'. In addition, separate accounting code has been given to each service. See next chapter pages for account head for each type of service.

TR-6 challan (in yellow colour in quadruplicate) is for payment in conventional mode while GAR-7 (one challan in yellow colour with counterfoil) is used when Bank is having 'EASIEST facility'. In both cases, payment is by cash or cheque.

The tax paid should be rounded off in rupees. Education cess and SAH education cess should be shown separately under separate account head in TR-6/GAR-7 challan.

Presentation of cheque on or before due date is sufficient - Rule 6(2A) provides that cheque of proper amount should be deposited with bank on or before due date. It will be deemed to have been paid on due date, even if the cheque is realised later. However, if cheque is not realised, service tax will not be deemed to have been paid.

If last date is a holiday - If last day of payment and filing return is a public holiday, tax can be paid and return can be submitted on next working day - CBE&C circular No. 63/12/2003-ST dated 14-10-2003.

Electronic Accounting System In Excise and Service Tax (EASIEST) - 'Easiest' has been developed to make payment of tax easy. The facility is available with some 28 banks. The payment is made by GAR-7 challan. Assessee has to make one copy of challan and its counterfoil.

Mandatory e-payment if annual service tax payment exceeds Rs 50 lakhs - e-payment is a mode of payment in addition to the conventional methods of payment offered by the banks under specific security norms of Reserve Bank of India. This scheme facilitates anytime, anywhere payment and an instant cyber receipt is generated once the transaction is complete. It provides the convenience of making online payment of Central Excise and Service Tax through Bank's Internet banking service. About 28 Banks are authorised for this purpose.

Proviso to rule 6(2) of Service Tax Rules makes e-payment mandatory for payment of duty by all assessees who have paid Service tax of rupees 50 lakh or more in cash during the preceding financial year, w.e.f. 1-10-2006.

Mandatory interest for late payment of service tax - In case of delayed payment of service tax, there is mandatory payment of simple interest under section 75 for the period which the payment is delayed. The interest rate is 13% w.e.f. 10-9-2004, vide notification No. 26/2004-ST dated 10-9-2004 [Earlier interest @ 15% per annum from 11-5-2002. The interest rate was 24% upto 11-5-2002].

Returns

Every assessee has to submit half yearly return in form ST-3 in triplicate within 25 days of the end of the half-year. 'Half year' means 1st April to 30th September and 1st October to 31st March of financial year. The return should be accompanied by TR-6/GAR-7 challans, evidencing payment of duty. Details in respect of each service are to be provided separately. However, service tax payment details and Cenvat credit details are common and combined.

There is no column to show excess amount paid, if any. Presumably, this will have to be intimated by a separate letter and/or given in the ST-3 form as a 'remark' or 'note'.

Last date for filing return is a bank holiday - If last day of payment and filing return is a public holiday, tax can be paid and return can be submitted on next working day - CBE&C circular No. 63/12/2003-ST dated 14-10-2003.

Revised return - Rule 7B of Service Tax Rules has been inserted w.e.f. 1-3-2007 to allow an assessee to rectify mistakes and file revised return within 90 days from the date of filing of the original return. Rule 9(11) of Cenvat Credit Rules (inserted w.e.f. 1-3-2007) allows an assessee to rectify mistakes and file revised return within 60 days from the date of filing of original return. This provision applies only to service providers and not to manufacturers.

What is to be done if mistake comes to notice after 90 days? – There is no provision for submission of revised return after 90 days. In such cases, if assessee finds that he has made some mistake, he should pay the amount by TR-6 / GAR-7 challan and inform department suitably. If he has paid excess amount by mistake, he is required to file refund claim. He cannot adjust excess payment on his own, except in cases where it has been specifically permitted. If he has not taken Cenvat credit of certain inputs, input services or capital goods, he can avail it in subsequent period, since there is no time limit for availing Cenvat credit. This will be reflected in his return for that subsequent period, as in normal course.

Electronic filing of return - Department has introduced e-filing of service tax return on experimental basis from April, 2003. It is optional. The procedure has been described in CBE&C circular No. 52 / 1 / 2003-ST dated 11-3-2003. Guidelines are also issued in question answer form on CBE&C website. The facility is available to all service providers.

Late fee and penalty for filing late return - Section 70(1), as amended by Finance Act, 2007 w.e.f. 11-5-2007, makes provision for late filing of return with late fee which can be upto Rs 2,000. Late fee payable will be prescribed by Central Government by issuing a notification. The late fee payable is as follows – (a) Delay Upto 15 days – Rs 500 (b) Beyond 15 days and upto 30 days – Rs 1,000 (b) Delay beyond 30 days – Rs 1,000 plus Rs 100 per day of delay beyond 30 days, from 31st day maximum Rs 2,000- rule 7C inserted w.e.f. 12-5-2007.

Penalty can be waived if no tax was payable – Once a person is registered, he has to file return even if there is no tax liability. He should file Nil return if there was no service tax payable. However, if he does not file return, penalty can be waived / reduced if non-filing of return was for sufficient cause [rule 7C]

Department is required to accept late return even if late fee is not paid – In case of returns filed late, the appropriate late fees should be paid at the time of filing the return, without waiting for any communication or notice from the department. Mere non-submission of evidence of payment of late fee along with the return is, however, not a ground for refusal to allow filing of the return – para 6.4 of CBE&C Circular No. 97 / 8 / 2007-ST dated 23-8-2007.

Provisional assessment

Assessee can make request in writing for provisional assessment to Assistant / Deputy Commissioner. Provisions of Central Excise Rules in respect of provisional assessment are applicable, but there is no requirement of any bond [rule 6(4)].

Of course, reason has to be stated why he is not able to correctly determine his tax liability.

After such request is made, assessee has to submit memorandum in form ST-3A showing difference between service tax collected and deposited. Application for provisional assessment should be made to Assistant/Deputy Commissioner. Provisional assessment can be finalised by Assistant/Deputy Commissioner after calling further documents as may be necessary. - Rule 6(4), 6(5) and 6(6) of Service Tax Rules, 1994.

7.6 ADJUDICATION AND APPEALS

Central Excise Officers have been empowered to adjudicate in following -

(*a*) Demand of service tax and its recovery - section 73.

(*b*) Rectification of mistake by amending own order - section 74.

(*c*) Imposition of penalty - section 83A

(*d*) Refund of service tax - section 11B of Central Excise Act made applicable to Service Tax.

Time limit for issue of show cause notice - If it is found that assessee has paid less tax, department will issue a show cause notice cum demand.

If any service tax is not levied or not paid or short levied or short paid or erroneously refunded, Central Excise Officer shall issue a show cause notice for demand can be made within one year from 'relevant date' [section 73(1)].

If such short payment etc. was by reason of fraud, collusion, wilful mis-statement, suppression of facts or contravention of any provision of Finance Act, 1994 or rules, show cause notice can be issued within five years [*proviso* to section 73(1)]. After considering the representation, Central Excise Officer will determine the service tax payable. Such tax cannot be more than the amount specified in show cause notice. Thereupon, the person shall pay the amount so determined [section 73(2)].

Voluntary Payment before receipt of show cause notice - Assessee may pay such tax on the basis of his own ascertainment or on the basis of tax ascertained by Central Excise Officer, before issue of show cause notice. After payment of tax, assessee should inform the Central Excise Officer in writing about such payment, and then the central excise officer shall not issue any show cause notice under section 73(1) in respect of service tax so paid [section 73(3)].

Rectification - The Central Excise Officer who has passed order (of assessment or demand or penalty) can rectify any mistake apparent from the record, within two years of the date on which the order was passed. The mistake must be 'apparent from the records'.

Revision - The Commissioner of Central Excise can revise the orders passed by adjudicating authority subordinate to him. The revision order can be passed any time within two years of the original order, but not afterwards. No revision can be made if appeal against such order is pending with Commissioner (Appeals) [section 84]. Appeal against the order of Commissioner (after revision) lies with CESTAT under section 86.

Appeals

Appeal to Commissioner (Appeals) - Appeal to Commissioner (Appeals) can be made against order of any Central Excise Officer subordinate to Commissioner in respect of demand, interest or penalty or denial of refund of service tax. Appeal should be in prescribed form and duly verified. Appeal must be filed within three months from date of receipt of order. Delay upto three months can be condoned by Commissioner (Appeals). The procedures and powers will be similar to those under Central Excise. [section 85 of Finance Act, 1994].

Appeal to Tribunal - Appeal to CESTAT (Tribunal) can be made against order of Commissioner passed by him under section 73, 83A or 84 or order of Commissioner (Appeals) passed by him under section 85 [order in appeal from order of AC / DC] by assessee or the department. Appeal has to be filed within three months from date of receipt of order by assessee, Board or Commissioner as the case may be. [section 86 of Finance Act, 1996]. Tribunal can condone the delay in filing appeal on showing sufficient cause. Appeal has to be accompanied with prescribed fees, if appeal is by the assessee.

Tribunal is final fact finding authority.

Appeals to HC/SC – If issue involves classification or valuation, appeal lies with Supreme Court. If issue does not involve classification or valuation dispute, appeal lies with High Court only on substantial question of law.

Penalties

The penalties can be imposed by Central Excise Officers. There is no provision for prosecution under the Act.

Penalty for non-payment or delayed payment of service tax - If service tax is not paid or belatedly paid, penalty shall be imposed, which will be minimum Rs. 200 per day during which such failure continues or @ 2% per month, whichever is higher, starting with the first day after due date till date of actual payment of outstanding amount. Mercifully, the penalty cannot exceed the service tax which was payable. In addition, of course, service tax and interest is payable. [section 76 of Finance Act, 1994]. As per section 80, this penalty can be waived or reduced if proper cause is shown.

Penalty for contravention of Act or Rules - Penalty for contravention of any provision of the Chapter or Rules (of service tax) can be upto Rs. 1,000 [section 77]. The penalty can be waived under section 80, if assessee proves that failure was due to reasonable cause.

Penalty in case of fraud, suppression of facts etc. - Where any tax is not levied or paid or erroneously refunded, the person shall be liable to pay penalty which shall not be less than amount of service tax but can be upto twice the amount of service tax amount of service tax not levied or not paid or erroneously refunded [section 78]. The penalty can be waived under section 80, if assessee proves that failure was due to reasonable cause. [The penalty will be reduced to 25%, if tax, interest and penalty is paid within 30 days from date of receipt of order of Central Excise Officer].

7.7 EXPORT OF SERVICES

If service is exported, there is no service tax liability. If the service is exported, the Cenvat credit is not required to be reversed. Assessee can utilise credit for payment of service tax on other services. However, if this is not possible, he can get refund.

Service tax is required to be exempted only if there is actual export of service. 'Export of Services Rules, 2005' have been notified w.e.f. 15-3-2005. The rules make it clear that exemption from services / rebate of service tax and excise duty paid is admissible only if there is 'export of service' as defined in these rules. Mere receipt of payment in free foreign exchange will not be sufficient to treat the service as 'export service'.

Exemption or Rebate of Service tax - Exporter of service has three options -

(*a*) Export without payment of service tax and utilise Cenvat Credit for payment of service tax on other services.

(*b*) Export without payment of service tax and claim rebate of service tax paid on input services and excise duty paid on inputs (or forget about rebate as procedure is too complicated and impractical)

(*c*) Pay service tax on exported services and claim rebate (by this, he can utilise his input credit)

Meaning of Export of taxable service - Following conditions are common in respect of *all* taxable services - (**a**) The service should be provided from India and used outside India [rule 3(2)(a) of Export of Service Rules] and (**b**) Payment for such service is received by the service provider in convertible foreign exchange [rule 3(2)(b) of Export of Service Rules].

In addition, further conditions apply to different categories of services. Rule 3 of Export of Service Rules classifies the taxable services in four categories –

(i) Immovable property should be situated abroad [rule 3(i)]

(ii) Service should be at least partly performed outside India [rule 3(ii)]

(iii) Service can be provided firm Indian but recipient should be located outside India and order should be received from outside India [rule 3(iii)]

(iv) Services which not be treated as 'export of services' under any situation.

Services falling under each category are given in next chapter.

Rebate of service tax paid on exported services or tax paid on inputs/input services - Subsequent to issue of Export of Service Rules, 2005; two notifications have been issued making provisions for rebate.

(*a*) Notification No. 11 / 2005-ST dated 19-4-2005, providing for rebate of service tax and education cess paid on taxable services exported i.e. tax paid on output services

(*b*) Notification No. 12/2005-ST dated 19-4-2005, providing for rebate of excise duty paid on inputs and service tax paid on input services, which are used in providing exported taxable services.

Refund of input service tax and duty under Cenvat Credit Rules - Rule 5 of Cenvat Credit Rules has been amended w.e.f. 14-3-2006 to provide for refund of Cenvat credit when output service is exported. Procedure for claiming refund of service tax paid on input services and excise duty on inputs has been specified in notification No. 5/2006-CE(NT) dated 14-3-2006. Application should be submitted in Form 'A' to Assistant/Deputy Commissioner.

Application can be submitted every quarter. However, in following cases, refund can be claimed on monthly basis - (a) persons whose average export clearances are more than 50% of total clearances (b) EOU units. Refund of input service credit will be restricted to the extent of ratio of export turnover to the total turnover for the given period e.g. if total credit of input services is Rs. 100, total turnover is Rs. 500 and export turnover is Rs. 250, refund of input service tax credit will be only Rs. 50 (i.e. 50%, since export turnover is 50% of total turnover). The procedure seems to be simple. EOU is eligible to avail this procedure.

7.8 IMPORT OF SERVICES

The statutory provisions use the words 'Services provided from outside India and received in India'. However, generally, the tax is known as tax on 'Import of Services'.

Section 66A(1) (effective from 18-4-2006) provides that where any service specified in section 65(105) of Finance Act, is,— (a) provided or to be provided by a person who has established a business or has a fixed establishment from which the service is provided or to be provided or has his permanent address or usual place of residence, in a country other than India, and (b) received by a person (hereinafter referred to as the recipient) who has his place of business, fixed establishment, permanent address or usual place of residence, in India, such service shall, for the purposes of this section, be taxable service, and such taxable service shall be treated as if the recipient had himself provided the service in India, and accordingly all the provisions of this Chapter shall apply.

Exemption to individual receiving the service - First *proviso* to section 66A(1) states that where the recipient of the service is an individual and such service received by him is otherwise than for the purpose of use in any business or commerce, the provisions of this sub-section shall not apply.

When service provider has establishment at more than one places - Second *proviso* to section 66A(1) states that where the provider of the service has his business establishment both in that country and elsewhere, the country, where the establishment of the provider of service directly concerned with the provision of service is located, shall be treated as the country from which the service is provided or to be provided. Thus, even if a service provider has office in India as well as in foreign country, the service will be treated as provided from foreign country, if service is provided from that country.

Two permanent establishments to be treated as two separate persons - As per section 66A(2), where a person is carrying on a business through a permanent establishment in India and through another permanent establishment in a country other than India, such permanent establishments shall be treated as separate persons for the purposes of this section.

Intention seems only to tax services received in India - Though section 66A is broadly worded and covers even services provided and consumed abroad, it appears that intention is to tax only services received in India. *If so, then only possible objection can be violation of DTA.*

Service provided from outside India and received in India - Though scope of section 66A is wide, it can be argued that service tax is payable only if the service falls within the definition of 'Service provided from Outside India and Received in India'.

Classification of services - The rules classify all taxable services in four categories, namely (i) Services in relation to immovable property – the property should be situated in India – rule 3(i) (ii) Services should be at least partly performed in India [rule 3(ii)] (iii) Services received by recipient located in India [rule 3(iii)] (iv) Services which will never be treated as import of service. The classification is same as per export of Service Rules.

Service receiver liable to pay service tax - As per rule 2(1)(d)(iv) of Service tax Rules, person liable for paying the service tax means - in relation to any taxable service provided or to be provided by any person from a country other than India and received by any person in India under section 66A of the Act, the recipient of such service.

Thus, person receiving service in India will be liable to pay service tax. He will have to register under Service tax provisions and submit returns. Service receiver was made liable to pay service tax on services provided by non-resident by amending rules on 16-8-2002. In cases prior to that, it was held that service receiver cannot be made liable to pay service tax in case of services provided by non-resident.

Tax to be paid in cash without Cenvat credit - Rule 5 of Taxation of Services (Provided from outside India and Received in India) Rules, 2006 clarifies that the taxable service will not be treated as output service of the recipient for purpose of availing of Cenvat credit of duty of excise paid on inputs or service tax paid on any input services. Thus, the recipient of service has to pay the service tax in cash by TR-6/GAR-7 challan. He cannot utilise his Cenvat credit for payment of this amount, as it is not his 'output service', though he is liable to pay service tax.

Service receiver avail Cenvat credit of service tax paid by him - Though the person receiving the service is liable to pay service tax, the service is his 'input service'. Para 4.2-13 of MF(DR) circular No. B1/4/2006-TRU, dated 19-4-2006 confirms as follows 'Where such service is used as an input for providing any taxable output, the service tax paid on such service can be taken as input credit' (The TRU letters have not been withdrawn even when all other circulars have been withdrawn on 23-8-2007. Hence, TRU letters are still valid) [There is some controversy on this issue]

STUDY NOTE -8

TAXABLE SERVICES

This Study Note includes

- **Taxability of Various Kind of Services**

• Description of service	• Coverage	• Exclusions/Exemptions
• Advertising agency	• **Statutory coverage** • "advertisement" includes any notice, circular, label, wrapper, document, hoarding or any other audio or visual representation made by means of light, sound, smoke or gas [Section 65(2)] • Service connected with the making, preparation, display or exhibition of advertisement taxable. • Services of advertising consultant. Taxable [Section 65(3)] • **Case Law/Board Circulars** • Tax only on commission, not on advertisement charges paid to media or TV	• **Exclusions** • Sale of space or time for advertisement taxable under different head. • Space selling taxable under BAS • Preparing sign board or hoardings not taxable. • **Exemptions** • See for general exemptions Study Note-7.
• Air transport of passengers embarking for international travel	• **Statutory coverage** • Service in relation to scheduled or non-scheduled air transport of such passenger embarking in India for international journey, in any class other than economy class. • **Case Law/Board Circulars** • Tax is payable for entire journey even if there is stop over in between. • In case of round trip or return ticket, service tax is payable on total value of ticket.	• **Exclusions** • Economy class passengers are excluded. • **Exemptions** • See for general exemptions Study Note-7.

• Airport Services	• **Statutory coverage** • Service by airports authority or any person authorised by it, in an airport or a civil enclave. • **Case Law/Board Circulars** • Services statutorily provided by AAI as stated in MF(DR) circular No. B2/8/2004-TRU dated 10-9-2004 are only taxable.	• **Exemptions** • See for general exemptions Study Note -7
• Air travel agent	• **Statutory coverage** • Service in relation to the booking of passage for travel by air. • **Case Law/Board Circulars** • Tax is payable only on commission and other charges but relating to booking of passage for air travel.	• **Exclusions** • Services of GSA (General Sales Agent) appointed by foreign airlines are taxable under 'Business Auxiliary Service' and not under Air Travel Agent Service. • **Valuation** • Air travel agent has option to pay service tax @ 0.60% of basic fare in case of domestic booking and @ 1.20% of the basic fare in case of international bookings, of passage for travel by air. In addition, education cess @ 2% and SAH education cess @ 1% will be payable. • **Exemptions** • See for general exemptions Study Note - 7
• Architect	• **Statutory coverage** • Services in the field of architecture. • **Case Law/Board Circulars** • Designing or planning of construction of buildings, bridges, dams etc. and its supervision	• **Exclusions** • Actual execution of work is not Architect's services. • Interior design may be covered only to the extent of architecture. • No tax on material, furniture and temporary structures • **Exemptions** • See for general exemptions Study Note - 7

Asset Management including portfolio management	**Statutory coverage** • Asset management including portfolio management and all forms of fund management. **Case Law/Board Circulars** • Services provided by individual service providers especially to high net worth individuals taxable.	**Exclusions** • Services by banking company or a financial institution, NBFC or any other body corporate or commercial concern taxable under 'Banking and other Financial Services' **Exemptions** • See for general exemptions Study Note - 7
ATM operations, maintenance or management	**Statutory coverage** • Automated teller machine (ATM) operations, maintenance or management service, in any manner • Includes site selection, contracting of location, acquisition, financing, installation, certification, connection, maintenance, transaction processing, cash forecasting, replenishment, reconciliation and value-added services [section 65(9b)]	**Exclusions** • No service tax on cash withdrawn from ATM. **Exemptions** See for general exemptions Study Note - 7
Auctioneers' Service	**Statutory coverage** • Service in relation to auction of property, movable or immovable, tangible or intangible • Calling the auction or providing a facility, advertising or illustrating services, pre-auction price estimates, short-term storage services, repair or restoration services in relation to auction of property [section 65(7a)]	**Exclusions** • Auction of property under the directions or orders of a court of law or auction by the Government excluded. **Exemptions** • See for general exemptions Study Note -7

Authorised service station (Motor car / Two-wheelers / LMV)	**Statutory coverage** • Service by an authorised service station, in relation to any service, repair, reconditioning or restoration of motor cars, light motor vehicles or two wheeled motor vehicles, in any manner. • Light Motor Vehicle (LMV) means any motor vehicle constructed or adapted to carry more than six passengers, but not more than twelve passengers, *excluding* the driver [section 65(62)] **Case Law/Board Circulars** • Free service to our customers for which reimbursement obtained from manufacturers is taxable. • Service tax payable on spare parts used during provision of service - Ref Code 036.03 / 23.8.07 of CBE&C Circular No. 96 / 7 / 2007-ST dated 23-8-2007 [doubtful]	**Exclusions** • Service provided at the time of purchase of new vehicle is not liable to tax. • Service to transport vehicle, buses, trucks, omnibus, road-roller, tractor, or invalid carriage is not covered **Exemptions** See for general exemptions Study Note - 7
Banking and Financial services	**Statutory coverage** • Service by a banking company or a financial institution including NBFC, or any other body corporate or *commercial concern*, is taxable. • Financial leasing services including equipment leasing and hire-purchase. • Merchant banking services • Securities and foreign exchange (forex) broking; • Asset management including portfolio management, all forms of fund management, pension fund management, custodial, depository and trust services	**Exclusions** • Hire purchase finance not taxable – *Bajaj Auto Finance* v. *CCE* (2007) 9 STT 569 (CESTAT). • Money changers who buys and sells foreign exchange without charging commission or brokerage is not liable - Ref Code 034.01 / 23.8.07 of CBE&C Circular No. 96 / 7 / 2007-ST dated 23-8-2007.

• Advisory and other auxiliary financial services including investment and portfolio research and advice, advice on mergers and acquisitions and advice on corporate restructuring and strategy • Provision and transfer of information and data processing; • Banker to an issue services • Other specified financial services [section 65(12)] **Case Law/Board Circulars** • Cash management taxable • Business chit funds are taxable - CBE&C Ref Code 034.04/23.8.07 of CBE&C Circular No. 96/7/2007-ST dated 23-8-2007	• Stock Exchanges, commodity exchanges, stock clearing house services not liable – CBE&C letter No. 137/57/2006-CX.4 dated 18-5-2007 • Simple chit funds not taxable but business chit funds taxable - CBE&C Ref Code 034.04/23.8.07 of CBE&C Circular No. 96/7/2007-ST dated 23-8-2007 • No service tax on entry and exit load charged by mutual fund to the investor **Exemptions** • Services provided to Government for tax collection exempt - Notification No. 13/2004-ST dated 10-9-2004. • Services provided by RBI exempt –Notification No. 22/2006-ST dated 31-5-2006. • No service tax on interest charged by service provider - rule 6(2)(iv) • See for general exemptions Study Note - 7

Beauty treatment	**Statutory coverage** • Services includes hair cutting, hair dyeing, hair dressing, face and beauty treatment, cosmetic treatment, manicure, pedicure or counselling services on beauty, face care or make-up or such other similar services [section 65(17)]. **Case Law/Board Circulars** • Materials used such as cosmetics and toilet preparations are includible for valuation	**Exclusions** • No tax on plastic surgery - CBE&C circular No. B.11/1/2002-TRU dated 1-8-2002. **Exemptions** • See for general exemptions Study Note - 7
Broadcasting	**Statutory coverage** • Service by a broadcasting agency or organisation in relation to broadcasting • In the case of a broadcasting agency or organisation, having its head office situated in any place outside India, includes service provided by its branch office or subsidiary or representative in India or any agent appointed in India. • Services of selling of time slots for broadcasting of any programme or obtaining sponsorships for programme and collecting broadcasting charges is a taxable service. [section 65(16)]	**Exemptions** • Exemption to services by digital cinema service provider to distributor or producer - Notification No. 12/2007-Service Tax dated 01.03.2007. • See for general exemptions Study Note - 7

Business auxiliary services	**Statutory coverage** • Promotion or marketing or sale of goods produced or provided by or belonging to the client • Promotion or marketing of service provided by the client • any customer care service provided on behalf of the client • procurement of goods or services, which are inputs for the client • production or processing of goods for, or on behalf of, the client • provision of service on behalf of the client • a service incidental or auxiliary to any activity specified above, such as billing, issue or collection or recovery of cheques, payments, maintenance of accounts and remittance, inventory management, evaluation or development of prospective customer or vendor, public relation services, management or supervision. • services as a commission agent [section 65(19)]	**Exclusions** • 'Information Technology Service' means any service in relation to (a) designing or developing of computer software, or (b) system networking, or (c) any other service primarily in relation to operation of computer systems, is excluded. • Activity that amounts to "manufacture" within the meaning of section 2(f) of the Central Excise Act is excluded. **Exemptions** • The services of production or processing of goods in relation to ***agriculture, printing, textile processing or education*** are fully exempt [Notification No. 14/2004-ST dated 10-9-2004].

	Case Law/Board Circulars • Job work liable to service tax, but job work done under Cenvat provisions exempt. Job work not taxable if it amounts to 'manufacture'.	• Job work exempt if the goods after processing are returned back to client (raw material supplier) for use in or in relation to manufacture of 'other goods' by the client. The 'other goods' should be such that appropriate duty should be payable on such goods - notification No. 8/2005-ST dated 1-3-2005. • Job workers of parts and accessories of cycles, cycle rickshaws and
usiness xhibition	**Statutory coverage** • An exhibition, — (a) to market; or (b) to promote; or (c) to advertise; or (d) to showcase, - - - any product or service, intended for the growth in business of the producer or provider of such product or service [section 65(19a)] **Case Law/Board Circulars** • Organizers of events such as trade fairs, road shows, fashion shows, display show-cases kept in airports, railway stations, hotels etc. would be covered under this new levy.	**Exemptions** • See for general exemptions Study Note - 7

Business Support Services	**Statutory coverage** • Services provided in relation to business or commerce • Evaluation of prospective customers, telemarketing, processing of purchase orders and fulfilment services, information and tracking of delivery schedules, managing distribution and logistics, customer relationship management services, accounting and processing of transactions, operational assistance for marketing, formulation of customer service and pricing policies • Infrastructural support services • Other transaction processing [section 65(104c)]	**Exemptions** • See for general exemptions Study Note - 7
Cable	**Statutory coverage** • Service provided by cable operator, including multi-system operator • transmission by cables of a programme including retransmission by cable of any broadcast television signals is taxable [section 65(22)]. **Case Law/Board Circulars** • Broadcasting services provided by cable operators are also taxable. • Service tax is not leviable on entertainment tax levied by State Government, if it is shown separately in the Bill of cable operator to the customer - CBE&C circular No. B.11/1/2002-TRU dated 1-8-2002.	**Exemptions** See for general exemptions Study Note - 7

Cargo handling	**Statutory coverage** • Loading, unloading, packing or unpacking of cargo • Cargo handling services provided for freight in special containers or for non-containerised freight • Services provided by a container freight terminal or any other freight terminal, for all modes of transport	**Exclusions** • Handling of export cargo or passenger baggage is excluded. • Mere transportation of goods excluded. **Exemptions** • Cargo handling services relating to
Cleaning Activity	**Statutory coverage** • Cleaning • specialised cleaning services • disinfecting, exterminating or sterilising of objects or premises, of — (i) commercial or industrial buildings and premises thereof; or (ii) factory, plant or machinery, tank or reservoir of such commercial or industrial buildings and premises [section 65(24b)]	**Exclusions** • Services in relation to agriculture, horticulture, animal husbandry or dairying • 'Cleaning' of goods i.e. movable property will not be taxable under this head • Cleaning of residential buildings and premises has been excluded from the provisions **Exemptions** • See for general exemptions Study Note - 7
Clearing & Forwarding Agent	**Statutory coverage** • Service, either directly or indirectly, connected with clearing and forwarding operations • It includes a consignment agent. [section 65(25)] **Case Law/Board Circulars** • Services of coal merchants, who are acting as buyer's agents and carry out such jobs / assignments as asked for by respective consumers / buyers are covered under definition of C&F Agent and are liable to service tax - CBE&C letter F No. 159 / 1 / 2003-CX.4	**Exemptions** • See for general exemptions Study Note - 7

	• Mere procuring or booking orders for the Principal by an agent on commission basis would not be 'Clearing and forwarding Agent service' - *Larsen and Toubro Ltd.* v. *CCE* (2006) 4 STT 231 (CESTAT 3 member bench) • A commission agent is not a 'C&F' agent – *CCE* v. *Chandan Chemicals* (2007) 9 STT 556 (CESTAT).	

Club or Association's services	**Statutory coverage** • Service to members, by any club or association in relation to provision of services, facilities or advantages for a subscription or any other amount **Case Law/Board Circulars** • As per section 2 of Charitable Endowments Act, 1890, 'charitable purpose' includes relief to poor, education, medical relief and the advancement of any other object of general public utility, but does not include a purpose which relates exclusively to religious teaching or worship. • Service tax will be payable on life membership fees - para 10.6 of MF(DR) circular No. B1/6/2005-TRU dated 27-7-2005.	**Exclusions** "Club or association" does not include— (i) any body established or constituted by or under any law for the time being in force; or (ii) any person or body of persons engaged in the activities of trade unions, promotion of agriculture, horticulture or animal husbandry (iii) any person or body of persons engaged in any activity having objectives which are in the nature of public service and are of a charitable, religious or political nature (iv) any person or body of persons associated with press or media [section 65(25a)]

		Exemptions • Exemption to Services of housing societies or Resident Welfare Associations to their members are exempt vide notification No. 8/2007-ST dated 01-03-2007, if the monthly contribution is less than Rs 3,000. • See for general exemptions Study Note - 7

Commercial or Industrial Construction	**Statutory coverage** Following services used, or to be used, primarily for commerce or industry, or work intended for commerce or industry are taxable - (a) construction of a new building or a civil structure or a part thereof (b) construction of pipeline or conduit (c) completion and finishing services such as glazing, plastering, painting, floor and wall tiling, wall covering and wall papering, wood and metal joinery and carpentry, fencing and railing, construction of swimming pools, acoustic applications or fittings and other similar services, in relation to building or civil structure (d) repair, alteration, renovation or restoration of, or similar services in relation to, building or civil structure, pipeline or conduit [section 65(25b)] **Case Law/Board Circulars** • Educational, religious, Government buildings etc. not taxable. • If builder / promoter / developer undertakes construction work on his own without engaging the services of any other person, it is not taxable – Ref Code 079.01/23.8.07 of CBE&C Circular No. 96/7/2007-ST dated 23-8-2007. • Sub-contractors providing the construction services (to main contractor or to any other person) will be liable to service tax.	**Exclusions** • such services provided in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams [section 65(25b)] • If Vat/sales tax is payable on goods involved in the contract, the service will be classifiable under 'works contract' service tax. **Valuation** • Any person providing taxable service of commercial or industrial construction can opt to pay service tax on 33% of gross amount charged. *This is at the option of service provider* This relaxation is *not* available if only completion and finishing services are provided - Notification No. 1/2006-ST dated 1-3-2006. The partial exemption is available only if the gross amount charged includes value of goods and materials supplied or provided or used by provider of the commercial or industrial construction of service for providing such service (*Explanation* to Notification No. 1/2006-ST]. *However, value of land is not required to be added as it is neither goods nor material.* **Exemptions** • Construction and works contract services relating to port or other port are exempt. However, services of completion and finishing, repair, alteration, renovation, restoration, maintenance or repair provided in relation to existing port or other port are not exempt - Notification No. 25/2007-ST dated 22-5-2007 • See for general exemptions Study Note - 7

Construction of residential Complex	**Statutory coverage** Following services relating to construction of residential complex comprising of a building or buildings, having more than twelve residential units, a common area; and one or more common facilities – *(a)* construction of a new residential complex or a part thereof *(b)* completion and finishing services in relation to residential complex such as glazing, plastering, painting, floor and wall tiling, wall covering and wall papering, wood and metal joinery and carpentry, fencing and railing, construction of swimming pools, acoustic applications or fittings and other similar services *(c)* repair, alteration, renovation or restoration of, or similar services in relation to, residential complex [section 65(30a) and [section 65(91a)]] **Case Law/Board Circulars** a. If builder / promoter / developer undertakes construction work on his own without engaging the services of any other person, it is not taxable – Ref Code 079.01/23.8.07 of CBE&C Circular No. 96/7/2007-ST dated 23-8-2007. b. Sub-contractors providing the construction services (to main contractor or to any other person) will be liable to service tax.	**Exclusions** 1. A complex which is constructed by a person directly engaging any other person for designing or planning of the layout, and the construction of such complex is intended for personal use as residence by such person - "personal use" includes permitting the complex for use as residence by another person on rent or without consideration 2. If Vat/sales tax is payable on goods involved in the contract, the service will be classifiable under 'works contract' service tax. **Valuation** ◆ Any person providing taxable service of commercial or industrial construction can opt to pay service tax on 33% of gross amount charged. *This is at the option of service provider* This relaxation is *not* available if only completion and finishing services are provided - Notification No. 1/2006-ST dated 1-3-2006. The partial exemption is available only if the gross amount charged includes value of goods and materials supplied or provided or used by provider of the commercial or industrial construction of service for providing

Consulting Engineer	**Statutory coverage** • Advice, consultancy or technical assistance in any manner in one or more disciplines of engineering including the discipline of computer hardware engineering but excluding the discipline of computer software engineering. **Case Law/Board Circulars** • Technical assistance, training, software support are all 'taxable services' - In *Nokia (I) P Ltd.* v. *CC* (2006) 3 STT 209 (CESTAT) • Services of Valuation taxable - *V. Shanmughavel* v. *CCE* 2001 STT 132 = 6 STT 183 = 121 Taxman 274 = 2 STR 466 (Mad HC DB) • Contract for execution of a project is not consulting engineering service - *Ircon International Ltd.* v. *CCE* (2005) 2 STT 264 (CESTAT). • Royalty payment for use of technology and know-how cannot be equated with any services provided by foreign collaborator. Hence, no service tax is payable on such royalty payment - *Navinon Ltd.* v. *CCE* (2007) 6 STT 411 = 2004 STT 601 (CESTAT).	**Exclusions** • Services in discipline of computer software engineering **Exemptions** • Cess is payable under section 3 of Research and Development Cess Act, 1986, on transfer of technology. If such cess is payable, the consulting engineer will be granted exemption from service tax to the extent of cess paid - Notification No. 18/2002-ST dated 16-12-2002. Thus, if value of service is Rs 100, tax payable is Rs 12 and cess paid is Rs 5, net service tax actually payable will be Rs 7. • See for general exemptions Study Note - 7

Convention	**Statutory coverage** • "Convention" means a formal meeting or assembly which is not open to the general public, but does not include a meeting or assembly, the principal purpose of which is to provide any type of amusement, entertainment or recreation [section 65(32)] **Case Law/Board Circulars** • Service of providing room / hall for convention, video conferencing, head projectors, LCD projector, speakers, microphones, technical staff for operating these equipments, stationery etc. is covered.	**Exemptions** • In case of convention services provided by any person, service tax is payable only on 60% of the gross amount charged by the service provider for providing taxable service, if the gross amount includes charges for catering services. 'Catering service' means supply of a substantial and satisfying meal. - Notification No. 1/2006-ST dated 1-3-2006. • See for general exemptions Study Note - 7
Courier	**Statutory coverage** • door-to-door transportation of time sensitive documents, goods or articles utilising the services of a person, either directly or indirectly, to carry or accompany such documents, goods or articles [section 65(33)]. **Case Law/Board Circulars** • Basic postal services not taxable. However, courier services (Speed Post), insurance services (Postal Life Insurance), agency or intermediary services on commission basis which are also provided by other commercial organizations, are taxable - Ref Code 999.02/23.8.07 of CBE&C Circular No. 96/7/2007-ST dated 23-8-2007. • Co-loaders i.e. persons providing services to courier liable (earlier circular withdrawn)	**Exclusions** • Basic postal services not taxable **Exemptions** • See for general exemptions Study Note - 7

Credit Card, debit card, charge or other payment cards related services	**Statutory coverage** • Service in relation to credit card, debit card, charge card or other payment card service • Receipt and processing of application, transfer of embossing data to issuing bank's personalisation agency, automated teller machine personal identification number generation, renewal or replacement of card, change of address, enhancement of credit limit, payment updation and statement generation • settlement of any amount transacted through such card • Service by the owner of trade marks or brand name to the issuing bank under an agreement, for use of the trade mark [section 65(33a)]	**Exemptions** See for general exemptions Study Note - 7
Credit Rating Agency	**Statutory coverage** • Credit rating of any debt obligation or of any project or programme requiring finance • Credit rating of any financial obligation, instrument or security for providing a potential investor or any other person any information pertaining to the relative safety of timely payment of interest or principal [section 65(34)] **Case Law/Board Circulars** • Surveillance fee collected by a Credit rating agency is taxable.	**Exclusions** • Information and advisory services rendered, research and information such as analysis of industries in a specific sector, financial and business outlook, indexing services, macro studies, financial modelling etc. are not in relation to credit rating and hence are not taxable. **Exemptions** • See for general exemptions Study Note - 7

Custom House Agent	**Statutory coverage** • Service in relation to the entry or departure of conveyances or the import or export of goods	**Exemptions** • See for general exemptions Study Note - 7
Design Services	**Statutory coverage** • Services provided in relation to designing of furniture, consumer products, industrial product, packages, logos, graphics, websites and corporate identity designing and production of three dimensional models [section 65(36b)] **Case Law/Board Circulars** Design services , other than the above specifically mentioned taxable services, like furniture design, aesthetic design, consumer or industrial products, logos, packaging, production of three dimensional models, etc. will be taxable under this category	**Exclusions** • Service provided by interior decorator and a fashion designer (they are covered under different head) **Exemptions** • See for general exemptions Study Note - 7
Development and supply of content services	**Statutory coverage** • Development and supply of content for use in telecommunication services, advertising agency services and on-line information and database access or retrieval services • Development and supply of mobile value added services, music, movie clips, ring tones, wall paper, mobile games, data, whether or not aggregated, information, news and animation films [section 65(36c)]	**Exemptions** • See for general exemptions Study Note - 7

Dredging	**Statutory coverage** • Removal of material including, silt, sediments, rocks, sand, refuse, debris, plant or animal matter in any excavating, cleaning, deepening, widening or lengthening, either permanently or temporarily, of any river, port, harbour, backwater or estuary [section 65(36a)] **Case Law/Board Circulars** • Excavation of material from sea, river or lake bed and putting the excavated material elsewhere for disposal is covered.	**Exemptions** • See for general exemptions Study Note - 7
Dry cleaning	**Statutory coverage** • 'Dry cleaning' includes dry cleaning of apparels, garments or other textile, fur or leather articles [section 65(37)] **Case Law/Board Circulars** • Dry cleaning includes tagging and inspection, pre-treatment, dry cleaning and post sorting. No tax is payable on wet cleaning, i.e. cleaning with water and water soluble detergents. Service tax is also not payable on job of dyeing, darning etc. - CBE&C circular No. B.11/1/2002-TRU dated 1-8-2002.	**Exemptions** • See for general exemptions Study Note - 7

Erection, Commissioning or installation	**Statutory coverage** • Erection, commissioning or installation of plant, machinery, equipment or structures, whether prefabricated or otherwise • Installation of—(a) electrical and electronic devices, including wirings or fittings therefor; or (b) plumbing, drain laying or other installations for transport of fluids; or (c) heating, ventilation or air-conditioning including related pipe work, ductwork and sheet metal work; or (d) thermal insulation, sound insulation, fire proofing or water proofing; or (e) lift and escalator, fire escape staircases or travelators; or (f) such other similar services [section 65(39a)] **Case Law/Board Circulars** • Supply of lift and its installation at site. It was held that it is a contract of 'sale' and not a 'works contract'. Skill and labour employed for converting the main components into lift was only incidental - *State of Andhra Pradesh* v. *Kone Elevators (India) Ltd.* 2005 (181) ELT 156 (SC 3 member bench). • Service tax payable even if excise duty paid on entire value of contract including erection charges – *Lincoln Helios (India) Ltd.* v. *CCE* (2006) 3 STT 311 (CESTAT).	**Exclusions** • If Vat / sales tax is payable on goods involved in the contract, the service will be classifiable under 'works contract' service tax. • Erection of Civil Structure not taxable **Valuation** • Value of erection, commissioning or installation may, *at the option of assessee*, be taken as 33% of gross amount of contract and service tax will be payable accordingly. The gross amount charged will include value of plant, machinery, equipment, structures, parts and other material sold - Notification No. 1/2006-ST dated 1-3-2006. **Exemptions** • See for general exemptions Study Note - 7

Event management	**Statutory coverage** • Service provided in relation to planning, promotion, organising or presentation of any arts, entertainment, business, sports, marriage or any other event • Includes any consultation provided in this regard [section 65(40)]	**Exclusions** • Service tax is not leviable on sale proceeds of tickets or revenue generated from the sale of space. - CBE&C circular No. B.11/1/2002-TRU dated 1-8-2002 **Exemptions** • See for general exemptions Study Note - 7
Fashion designing	**Statutory coverage** • Any activity relating to conceptualizing, outlining, creating the designs and preparing patterns for costumes, apparels, garments, clothing accessories, jewellery or any other article intended to be worn by human beings • Any other service incidental thereto [section 65(43)]	**Exclusions** • If fashion designer designs and makes garments himself and sells them, there is no service tax, as he is providing designing service to himself. - - - Services of tailor and jewellers are not taxable, as no designing is involved. - - - CBE&C circular No. B.11/1/2002-TRU dated 1-8-2002 **Exemptions** • See for general exemptions Syudy Note - 7
Forward contract	**Statutory coverage** • Service by a member of a recognized association or a registered association, in relation to a forward contract. • "Forward contract" means the contract for delivery of goods at future date and which is not for ready delivery contract.	**Exemptions** See for general exemptions Study Note - 7

Franchise	**Statutory coverage** • "Franchise" means an agreement by which the franchisee is granted representational right to sell or manufacture goods or to provide service or undertake any process identified with franchisor, whether or not a trademark, service mark, trade name or logo or any such symbol, as the case may be, is involved [section 65(47)] **Case Law/Board Circulars** • Some well known examples of franchise are - Coca-Cola, Pepsi, NIIT, Aptech, McDonald etc. • If vocational training is provided through franchisee, the service will be taxable under 'franchisee service' - *Jetking Information Ltd.* v. *CCE* (2007) 6 STT 444 (CESTAT)	**Exemptions** See for general exemptions Study Note - 7

General insurance	**Statutory coverage** • Services by an insurer, including re-insurer, in relation to general insurance business. **Case Law/Board Circulars** • No service tax if assets are in J&K - – DGST instruction No. V/DGST/03/GEN/INS/01/2004 dated 17-8-2004	**Exemptions** • Certain schemes like personal accident social security scheme, crop insurance, cattle insurance, janata policy, export credit insurance, insurance on export of goods from India are exempt - Notification No. 3/1994-ST dated 30-6-1994. • Jana Arogya Bima policy is exempt from service tax - Notification No. 12/1997-ST dated 14-2-1997. • Group personal accident policy for self employed women is exempt under notification No. 3/1994-ST dated 30-6-1994. Scheme of Rajasthan Government is exempt under notification No. 1/2000-ST dated 9-2-2000. • (a) Cattle insurance services are exempt. - Notification No. 4/2000-ST dated 31-7-2000 (b) National Agricultural Insurance Scheme, Seed Crop Insurance, Farm Income Insurance Scheme are exempt from service tax - Notification No. 3/2000-ST dated 6-7-2000 (c) Insurance of sheep is exempt upto 31-12-2009 – Notification No. 31/2006-ST dated 11-12-2006. • General Insurance Business service provided under Universal Health Insurance Scheme is exempt from service tax - Notification No. 16/2003-ST dated 11-7-2003. • See for general exemptions Study Note - 7

Health and fitness	**Statutory coverage** • Service for physical well being such as, sauna and steam bath, turkish bath, solarium, spas, reducing or slimming saloons, gymnasium, yoga, meditation, massage (*excluding* therapeutic massage) or any other like service [section 65(51)]	**Exclusions** • Institutions conducting diploma courses in yoga and research centers do not fall in the category of health club and will not be liable to service tax. - CBE&C circular No. B.11/1/2002-TRU dated 1-8-2002 **Exemptions** • See for general exemptions Study Note - 7
Insurance Auxiliary (General insurance)	**Statutory coverage** • Service to a policy holder or any person or insurer, including re-insurer, by an actuary, or intermediary or insurance intermediary or insurance agent, in relation to insurance auxiliary services concerning general insurance business. • Risk assessment, claim settlement, survey and loss assessment [section 65(55)] **Reverse charge - Person liable to pay service tax** • In respect of services provided by an insurance agent, the insurance company is the 'person liable for paying the service tax'. [section 68(2) of Finance Act, 1994 read with rule 2(1)(d)(iii) of Service Tax Rules, 1994]. The service tax is payable on commission payable to the insurance agent. However, the exemption available to small service providers cannot be availed by insurance agent.	**Exemptions** See for general exemptions Study Note - 7

Intellectual property	**Statutory coverage** • Transferring temporarily; or permitting the use or enjoyment of, any intellectual property right is taxable [section 65(55b)] • "intellectual property right" means any right to intangible property, namely, trademarks, designs, patents or any other similar intangible property, under any law for the time being in force, but does not include copyright [section 65(55a)]	**Exclusions** • Copyright service is excluded. • Permanent transfer of Intellectual Property not taxable **Exemptions** • Cess is payable under section 3 of Research and Development Cess Act, 1986, on transfer of technology. If such cess is payable, the holder of intellectual property right will be granted exemption from service tax to the extent of cess paid. - Notification No. 17/2004-ST dated 10-9-2004. Thus, if value of service is Rs 100, tax payable is Rs 12 and cess paid is Rs 5, net service tax actually payable will be Rs 7. • See for general exemptions Study Note - 7

Interior decorator	**Statutory coverage** • Planning, design or beautification of spaces, whether manmade or otherwise, in any manner • Advice, consultancy, technical assistance or in any other manner, services relating to planning, design or beautification of spaces • Landscape designer [section 65(59)] **Case Law/Board Circulars** • Services of vastu / Feng shui consultants are taxable • No tax on material, furniture, and temporary structures	**Exemptions** • See for general exemptions Study Note - 7
Internet cafe	**Statutory coverage** • Facility for accessing internet	**Exemptions** • See for general exemptions Study Note - 7
Internet telephony service	**Statutory coverage** • Telecommunication service through internet and includes fax, audio conferencing and video conferencing [section 65(57a)]	**Exemptions** • See for general exemptions Study Note - 7
Life insurance	**Statutory coverage** • Service in relation to risk cover in life insurance. **Case Law/Board Circulars** • Service tax is payable on gross amount charged in respect of risk portion of insurance premium.	**Valuation** • As per rule 6(7A), the insurance company will have option to pay tax at flat rate of 1% of the gross premium without showing any break-up. If policy is purely risk coverage, then service tax will be at full rate on the gross premium. **Exemptions** • See for general exemptions Study Note - 7

Mailing list compilation and mailing	**Statutory coverage** • Service in relation to— (i) compiling and providing list of name, address and any other information from any source; or (ii) sending document, information, goods or any other material in a packet, by whatever name called, by addressing, stuffing, sealing, metering or mailing; for, or on behalf of the client [section 65(63a)]	**Exemptions** • See for general exemptions Study Note - 7
Management, Maintenance or repair	**Statutory coverage** • Any service provided by— (i) any person under a contract or an agreement; *or* (ii) a manufacturer or any person authorised by him, - - in relation to, — (a) management of properties, whether immovable or not (b) maintenance or repair of properties whether immovable or not; or (c) maintenance or repair including reconditioning or restoration, or servicing of any goods or equipment, excluding motor vehicle • "Goods" includes computer software [section 65(64)] **Case Law/Board Circulars** • Services relating to maintenance or management of immovable property (such as roads, airports, railways, buildings, parks, electrical installations and the like) have been covered under the purview of service tax - para 16.2 of MF(DR) circular No. B1/6/2005-TRU dated 27-7-2005 • Services provided during the warranty period by the dealer or any other authorized person is taxable - CBE&C circular No. 59/8/2003 dated 20-6-2003. • Software maintenance is taxable. • AMC contracts taxable.	**Exclusions** • Services to motor vehicles not taxable under this head [section 65(64)] **Exemptions** • See for general exemptions Study Note - 7

Management or Business Consultant	**Statutory coverage** • Service in connection with the management of any organisation or business in any manner • Advice, consultancy or technical assistance, in relation to financial management, human resources management, marketing management, production management, logistics management, procurement and management of information technology resources or other similar areas of management [section 65(65)]	**Exclusions** • Executory services would not fall under 'consultancy services' - *Glaxo Smithkline Pharmaceuticals* v. *CCE* (2005) 1 STT 37 (CESTAT) – quoted with approval in *Glaxo Smithkline Consumer Healthcare* v. *CCE* (2007) 9 STT 496 (CESTAT). **Exemptions** • See for general exemptions Study Note - 7
Mandap keeper	**Statutory coverage** • "mandap" means any immovable property and includes any furniture, fixtures, light fittings and floor coverings therein let out for consideration for organising any official, social or business function [section 65(66)] • Social function includes marriage [section 65(67)] • Service provided as a caterer are included [section 65(105)(m)] **Case Law/Board Circulars** • Services of hotel or restaurant will be taxable if it provides 'mandap' services. – view confirmed in *Rajmalal Hotel* v. *CCE* (2007) 6 STT 11 (CESTAT).	**Exclusions** In *Social Service League* v. *CCE* (2006) 4 STT 283 (CESTAT), it has been held that drama performances conducted in a hall or mandap will not come under mandap keeper services. In a contrary view, in *ADA Rangamandira Trust* v. *CCE* (2007) 8 STT 206 (CESTAT), it was held that drama, music and dance should be held as social functions. **Exemptions** • If the mandap keeper provides catering services also and if his bill indicates that his bill is inclusive of charges for catering services, he has to pay service tax only on 60% of his gross charges to client. Catering service means supply of food - Notification No. 1/2006-ST dated 1-3-2006. • Use of precincts of a religious place as *mandap* is exempted from service tax - notification No. 14/2003-ST dated 20-6-2003, • See for general exemptions Study Note - 7

Manpower recruitment or supply agency	**Statutory coverage** • Recruitment or supply of manpower, temporarily or otherwise, in any manner • Services in relation to pre-recruitment screening, verification of the credentials and antecedents of the candidate and authenticity of documents submitted by the candidate. **Case Law/Board Circulars** • Academic / educational institutes providing recruitment services are taxable - Ref Code 010.01 / 23.8.07 of CBE&C Circular No. 96 / 7 / 2007-ST dated 23-8-2007. • Services of labour contractors are taxable w.e.f. 16-6-2005. • Service of providing employees of Agency to business or industrial organizations for a specific period is taxable - Ref Code 010.02 / 23.8.07 of CBE&C Circular No. 96 / 7 / 2007-ST dated 23-8-2007.	**Exemptions** • See for general exemptions Study Note - 7 **Valuation** • Service tax is to be charged on the full amount of consideration for the supply of manpower, whether full-time or part-time. The value includes recovery of staff costs from the recipient e.g. salary and other contributions. Even if the arrangement does not involve the recipient paying these staff costs to the supplier (because the salary is paid directly to the individual or the contributions are paid to the respective authority) these amounts are still part of the consideration and hence form part of the gross amount - per MF(DR) circular No. B1 / 6 / 2005-TRU dated 27-7-2005 para 22.4 (It is difficult to agree with this view. However, if the principal employer is in a position to avail Cenvat credit, it may be advisable to pay service tax on entire amount, instead of entering into fruitless and costly litigation).
Market research agency	**Statutory coverage** • Market research in any manner, in relation to any product, service or utility, including all types of customised and syndicated research services [section 65(69)]	**Exemptions** • See for general exemptions Study Note - 7

Mining of mineral, oil or gas services	**Statutory coverage** • Service in relation to mining of mineral, oil or gas**.**	**Exemptions** • See for general exemptions Study Note - 7
On-line information and data base access or retrieval (Computer network)	**Statutory coverage** • On-line information and database access or retrieval or both in electronic form through computer network • Providing data or information, retrievable or otherwise, to a customer, in electronic form through a computer network [section 65(75)] **Case Law/Board Circulars** • Following would be covered - (a) Internet Service Providers (ISP) (b) On line information provision and retrieval services like paid websites. However, e-commerce transactions are not covered as they do not charge surfers. - CBE&C letter No. B.II/I/2000-TRU dated 9-7-2001. • Providing matrimonial services on website is taxable – *prima facie* view in *Bharat Matrimony.com Pvt. Ltd.* v. *CST* (2007) 6 STT 85 (CESTAT)	**Exemptions** • See for general exemptions Study Note - 7
Opinion poll	**Statutory coverage** • Service designed to secure information on public opinion regarding social, economic, political or other issues [section 65(75a)]	**Exemptions** See for general exemptions Study Note - 7

Outdoor Caterer	**Statutory coverage** • Services in connection with catering at a place other than his own, but including a place provided by way of tenancy or otherwise by the person receiving such services [section 65(76a)] • "Caterer" means any person who supplies, either directly or indirectly, any food, edible preparations, alcoholic or non-alcoholic beverages or crockery and similar articles or accoutrements for any purpose or occasion [section 65(24)] **Case Law/Board Circulars** • Supply of food to airlines for in-flight service to passengers is taxable - *Saj Flight Services* v. *Superintendent of CE* (2006) 3 STT 165 (Ker HC) – confirmed in *Saj Flight Services* v. *Superintendent of CE* (2006) 5 STT 266 (Ker HC DB) • In case of canteen in office or factory run by canteen contractor, if the service is received by the employer, it will be taxable. If the service is directly provided to employees / workmen, then the canteen should not come within the definition.	**Exclusions** • Home delivery of food not taxable - MF(DR) circular No. B2 / 8 / 2004-TRU dated 10-9-2004. **Valuation** • The outdoor caterer can opt to pay service tax on 50% of his Bill amount. He can avail this concession if following conditions are satisfied - (a) The Bill or challan issued indicates that it is inclusive of charges for supply of food (Food means a substantial and satisfying meal, only snacks are not sufficient) (b) He does not take Cenvat credit of duty / service tax paid on inputs, input services and capital goods and (c) He does not avail benefit of notification No. 12 / 2003-ST dated 20-6-2003 - Notification No. 1 / 2006-ST dated 1-3-2006. **Exemptions** • See for general exemptions Study Note - 7

Packaging Activity	**Statutory coverage** • Packaging of goods including pouch filling, bottling, labelling or imprinting of the package [section 65(76b)] **Case Law/Board Circulars** • The intention seems to be to cover specialised packaging services like packing for transport etc. If packaging results in manufacture of new Article, excise duty will become payable.	**Exclusions** • Any packaging activity that amounts to 'manufacture' within the meaning of section 2(f) of Central Excise Act, 1944 is excluded. **Exemptions** • See for general exemptions Study Note - 7
Pandal or Shamiana	**Statutory coverage** • Service by a pandal or shamiana contractor • 'Pandal or shamiana' means a place specially prepared or arranged for organizing an official, social or business function. social function includes marriage [section 65(77a)] • Preparation, arrangement, erection or decoration of a pandal or shamiana • Supply of furniture, fixtures, lights and lighting fittings, floor coverings and other articles for use in pandal or shamiana [section 65(77b)]	**Valuation** If a pandal or shamiana contractor provides catering services of full meals, tax will be payable only on 70% of the gross amount charged to client - Notification No. 1/2006-ST dated 1-3-2006 **Exemptions** See for general exemptions Study Note - 7

hotography	**Statutory coverage** • "Photography" includes still photography, motion picture photography, laser photography, aerial photography or fluorescent photography [section 65(78)] **Case Law/Board Circulars** • In *Live Tone* v. *State of Tripura* (2001) 122 STC 115 (Gau HC), it was held that works contract tax (Vat) can be levied on the value of goods transferred (i.e. negative and printing paper) but not on whole price which includes charge of artistic skill required in developing photograph – same view in *Classic Colour Lab* v. *DCCT* (1998) 110 STC 269 (Kar HC) * *Bavens* v. *UOI* (1995) 97 STC 161 (Ker HC DB)	**Exclusions** • X-ray or CT scan will not be covered as in common parlance they are not photography studios or agencies. - CBE&C letter No. B.II/I/2000-TRU dated 9-7-2001. **Valuation** • In *Laxmi Colour* v. *CCE* (2005) 2 STT 220 = 3 STR 363 (CESTAT), it was held that no deduction of material cost is allowable. It was also held that in service like photography, there is no element of sale of goods. Thus, tax is payable on entire amount. **Exemptions** • See for general exemptions Study Note - 7

Port and other port	**Statutory coverage** • Service by a port or any person authorised by the port in relation to port services **Case Law/Board Circulars** • In *Homa Engg Works* v. *CCE* (2005) 2 STT 157 (CESTAT), it was held that only port services authorised by Board of Trustees of port under section 42(4) of Major Port Trust Act where rates are specified by Board by notification, are taxable – same view in *Western (I) Shipyard Ltd.* v. *CCE* (2007) 8 STT 338 (CESTAT) * *Homa Engg Works* v. *CCE* (2007) 9 STT 294 (CESTAT). • Service tax is payable on * port and dock charges, port dues * Cargo handling and storage charges * Railway haulage charges * Container handling charges * Labour charges for handling goods * Demurrage charges if goods are not cleared in time. Dock Labour Board is liable to pay service tax on labour charges recovered by them - CBE&C letter No. B.II/I/2000-TRU dated 9-7-2001.	**Exemptions** • Site formation and clearance, excavation and earthmoving and demolition services provided in course of construction of ports and other ports have been exempted *vide* Notification No. 17/2005-ST dated 7-6-2005. • Construction and works contract services relating to ports exempt, but no exemption to finishing or repairing services - Notification No. 25/2007-ST dated 22-5-2007 (effective from 1-6-2007). • See for general exemptions Study Note - 7

Practising CA / CWA / CS Services	**Statutory coverage** • Service by a Practising Chartered Accountant / Cost Accountant / Company Secretary in his professional capacity	**Exemptions** • Services provided by practising CA / CWA / CS in his professional capacity to a client, relating to representing before any statutory authority in the course of proceedings initiated under any law for the time being in force, by way of issue of notice, are exempt from service tax. All other services provided by practising CA / CWA / CS in his professional capacity are taxable (Notification No. 25 / 2006-ST dated 13-7-2006). • See para 12.3 for general exemptions
Programme Production (of TV or Radio programmes)	**Statutory coverage** • Service by a programme producer, in relation to a programme. • "Programme" means any audio or visual matter, live or recorded, which is intended to be disseminated by transmission of electro-magnetic waves through space or through cables intended to be received by the general public either directly or indirectly through the medium of relay stations [section 65(86a)]	**Exemptions** • See for general exemptions Study Note - 7

Public relations management service	**Statutory coverage** • Service in relation to managing the public relations of another person • "Public relations" includes strategic counselling based on industry, media and perception research, corporate image management, media relations, media training, press release, press conference, financial public relations, brand support, brand launch, retail support and promotions, events and communications and crisis communications [section 65(86c)]	**Exemptions** • See for general exemptions Study Note - 7
Rail travel agent	**Statutory coverage** • Service in relation to booking of passage for travel by rail	**Exclusions** • Tax is *not payable* on rail fare collected by rail travel agent - rule 6(2)(iii) of Service Tax Valuation Rules. **Exemptions** • See for general exemptions Study Note - 7
Real estate agent	**Statutory coverage** • Advice, consultancy or technical assistance, in relation to evaluation, conception, design, development, construction, implementation, supervision, maintenance, marketing, acquisition or management, of real estate [section 65(89)] • Service in relation to sale, purchase, leasing or renting, of real estate. • Services of Real estate consultant [section 65(88)]	**Exemptions** • See for general exemptions Study Note - 7

Recovery Agent	**Statutory coverage** • Service in relation to recovery of any sums due to banking company or financial institution, including a non-banking financial company, or any other body corporate or a firm.	**Exemptions** • See for general exemptions Study Note - 7
Registrar to an issue	**Statutory coverage** • Activities in relation to an issue including collecting application forms from investors, keeping a record of applications and money received from investors or paid to the seller of securities, assisting in determining the basis of allotment of securities, finalising the list of persons entitled to allotment of securities and processing and despatching allotment letters, refund orders or certificates and other related documents [section 65(89c)] • "Issue" means an offer of sale or purchase of securities to, or from, the public or the holder of securities [section 65(59a)]	**Exemptions** • See for general exemptions Study Note - 7

Rent-a-Cab operator	**Statutory coverage** • Service in relation to the renting of a cab • "cab" means - (i) a motorcab, or (ii) a maxicab, or (iii) any motor vehicle constructed or adapted to carry more than twelve passengers, excluding the driver, for hire or reward [section 65(20)] **Case Law/Board Circulars** • If a driver is provided with cab, it is still rent-a-cab service – *Shiva Travels* v. *CCE* (2006) 7 STT 75 (CESTAT).	**Exclusions** • Maxicab referred to in sub-clause (ii) or motor vehicle referred to in sub-clause (iii) rented for use by an educational body imparting skill or knowledge or lessons on any subject or field, other than a commercial training or coaching centre, is excluded. • Ambulances are not meant for carrying passengers for hire or reward. Hence, service tax liability does not arise - para 7.2.1 of D.O. F. No. 334/1/2007-TRU dated 28-2-2007. **Exemptions** • Service tax is payable only on 40% of the gross amount charged by the operator for providing taxable service, if the Rent-a-cab operator does not avail Cenvat of duty/tax paid on inputs, input services and capital goods and he does not avail benefit of notification No. 12/2003-ST dated 20-6-2003 - Notification No. 1/2006-ST dated 1-3-2006. • See for general exemptions Study Note - 7

Renting of immovable property	**Statutory coverage** • Renting of immovable property for use in the course or furtherance of business or commerce. • "Immovable property" includes - (i) building and part of a building, and the land appurtenant thereto (ii) land incidental to the use of such building or part of a building (iii) the common or shared areas and facilities relating thereto; and (iv) in case of a building located in a complex or an industrial estate, all common areas and facilities relating thereto, within such complex or estate. • "Renting of immovable property" includes renting, letting, leasing, licensing or other similar arrangements of immovable property for use in the course or furtherance of business or commerce [section 65(90a)] • Use of immovable property as factories, office buildings, warehouses, theatres, exhibition halls and multiple-use buildings is covered [Explanation to section 65(90a)]	**Exclusions** • Renting of following is not included – (a) vacant land solely used for agriculture, aquaculture, farming, forestry, animal husbandry, mining purposes (b) vacant land, whether or not having facilities clearly incidental to the use of such vacant land (c) and used for educational, sports, circus, entertainment and parking purposes; and (d) building used solely for residential purposes and buildings used for the purposes of accommodation, including hotels, hostels, boarding houses, holiday accommodation, tents, camping facilities [section 65(90a)] • Renting of immovable property by a religious body or to a religious body; or renting of immovable property to an educational body, imparting skill or knowledge or lessons on any subject or field, other than a commercial training or coaching center is excluded [section 65(90a)] **Exemptions** • Deduction of property tax will be allowed in respect of tax actually paid (and not on payable basis). Deduction will be on *pro rata* basis. Service tax is payable only on rent actually received from service receiver. • See for general exemptions Study Note - 7

Sale of advertising space or time	**Statutory coverage** • Sale of space or time for advertisement, in any manner is a 'taxable service' • Providing space or time, as the case may be, for display, advertising, showcasing of any product or service in video programmes, television programmes or motion pictures or music albums, or on billboards, public places, buildings, conveyances, cell phones, automated teller machines, internet • Selling of time slots on radio or television by a person, other than a broadcasting agency or organisation • Aerial advertising • Sale of space in yellow pages, business directories	**Exclusions** • Sale of space for advertisement in print media. "Print media" means - (i) "newspaper" (ii) "book" but does not include business directories, yellow pages and trade catalogues which are primarily meant for commercial purposes • Sale of time slots by a broadcasting agency or organisation (It is taxable under different head) **Exemptions** • See for general exemptions Study Note - 7
Scientific and technical consultancy	**Statutory coverage** • Service by a scientist or a technocrat, or any science or technology institution or organisation, in relation to scientific or technical consultancy **Case Law/Board Circulars** • Executory services would not fall under 'consultancy services' - *Glaxo Smithkline Pharmaceuticals* v. *CCE* (2005) 1 STT 37 (CESTAT) – quoted with approval in *Glaxo Smithkline Consumer Healthcare Ltd.* v. *CCE* (2007) 9 STT 496 (CESTAT).	**Exclusions** • Service tax is not payable by doctors, medical colleges, nursing homes, hospitals, diagnostic and pathological labs etc. as in common parlance they are not known as scientists, technocrats etc. - CBE&C letter No. B.II/I/2000-TRU dated 9-7-2001. **Exemptions** • Notification No. 9/2007-ST dated 01.03.2007 exempts all taxable services provided by incubators. • Service tax exemption is also provided to incubates vide notification No. 10/2007-ST dated 1-3-2007: • See for general exemptions Study Note - 7

Security agency	**Statutory coverage** • Services by security agency in relation to the security of any movable or immovable property or person, by providing security personnel or otherwise • Provision of services of investigation, detection or verification of any fact or activity [section 65(94)] **Case law/Board circulars** • Service tax payable on services of safe deposit lockers. • Services provided by ex-servicemen or charitable organization taxable w.e.f. 18-4-2006.	**Valuation** • Service tax is payable on gross amount charged for service. It has been clarified that service tax is payable on entire amount charged by security agency to client, which includes salary of guards, employer's ESIC, PF, contribution towards labour funds, bonus, leave, uniform etc. No abatement can be granted in respect of such expenses incurred by security agency. • In *Panther Detective Services* v. *CCE* (2007) 8 STT 215 (CESTAT), it was held that service tax is payable on gross amount including ESI, PF and wages of guards. The amount should be inclusive of service tax and then back calculations should be made – same view in *Punjab Ex-Serviceman Corpn* v. *CCE* (2005) 2 STT 273 (CESTAT). **Exemptions** • See for general exemptions Study Note - 7
Share Transfer Agent	**Statutory coverage** • Maintaining record of holders of securities and deals with all matters connected with the transfer or redemption of securities or activities incidental thereto [section 65(95a)]	**Exemptions** • See for general exemptions Study Note - 7

Site formation and clearance etc.	**Statutory coverage** • Services in relation to site formation and clearance, excavation and earthmoving and demolition and such other similar activities. • drilling, boring and core extraction services for construction, geophysical, geological or similar purposes • soil stabilization • horizontal drilling for the passage of cables or drain pipes • land reclamation work • contaminated top soil stripping work • demolition and wrecking of building, structure or road [section 65(97a)]	**Exclusions** • Services in relation to agriculture, irrigation, watershed development • Drilling, digging, repairing, renovating or restoring of water sources or water bodies. **Exemptions** • Exemption to services relating to roads, airports, railways, transport terminals etc. bridges, port etc. - Notification No. 17/2005-ST dated 7-6-2005 • See for general exemptions Study Note - 7
Sound recording	**Statutory coverage** • Recording of sound on any media or device including magnetic storage device • Services relating to recording of sound in any manner such as sound cataloguing, storing of sound and sound mixing or re-mixing or any audio post-production activity [section 65(98)]	**Exemptions** See for general exemptions Study Note - 7

Sponsorship service	**Statutory coverage** • Service in relation to sponsorship • "Sponsorship" includes naming an event after the sponsor, displaying the sponsor's company logo or trading name, giving the sponsor exclusive or priority booking rights, sponsoring prizes or trophies for competition [section 65(99a)] • Service tax is leviable only when the sponsor is any body corporate or firm [section 65(105)(zzzn)] **Reverse charge - Person liable for payment of tax** • In case of sponsorship service provided to a body corporate or firm located in India, the body corporate or firm receiving such sponsorship service will be liable to pay service tax [rule 2(1)(d)(vii)]. • If the recipient of sponsorship service is located outside India, service tax is required to be paid by the service provider and not by the recipient.	**Exclusions** • Sponsorship of sports events is excluded from the scope of this levy • Any financial or other support in the form of donations or gifts, given by the donors is not taxable, if the service provider is under no obligation to provide anything in return to such donors [section 65(99a)] **Exemptions** • See for general exemptions Study Note - 7
Steamer agent	**Statutory coverage** • Service in relation to a ship's husbandry or dispatch or any administrative work related thereto • Booking, advertising or canvassing of cargo • Container feeder services [section 65(100)] **Case Law/Board Circulars** • Expenses paid by steamer agent on behalf of shipping line not liable to service tax - CBE&C circular No. B 43/1/97-TRU dated 6-6-1997.	**Exemptions** • See for general exemptions Study Note - 7

Stock-broking	**Statutory coverage** • Service by a stock-broker in connection with the sale or purchase of securities listed on recognised stock exchange. • As per rule 6(1)(i) of Service Tax Valuation Rules (Earlier, it was *Explanation* 1 clause (a) to section 67 upto 18-4-2006), the value of taxable services shall include the commission or brokerage charged by a broker on the sale or purchase of securities including the commission or brokerage paid by the stock-broker to any sub-broker. **Case Law/Board Circulars** • No tax on turnover charges payable to stock exchange – *prima facie* view in *JSEL Securities Ltd.* v. *CCE* (2007) 8 STT 428 (CESTAT).	**Exemptions** See for general exemptions Study Note - 7
Storage and warehousing	**Statutory coverage** • Services in relation to storage and warehousing of goods, including liquids and gases [section 65(102)] **Case Law/Board Circulars** • Storage outside the port premises is taxable - *Gujarat Chem Port Terminal Co. Ltd.* v. *CC* (2005) 1 STT 98 (CESTAT) • Storage of empty containers taxable - CBE&C circular No. 60/9/2003-ST dated 10-7-2003	**Exclusions** • Service provided for storage of agricultural produce or any service provided by a cold storage excluded [section 65(102)] **Exemptions** • See for general exemptions Study Note - 7
Survey and exploration of mineral	**Statutory coverage** • Geological, geophysical or other prospecting, surface or sub-surface surveying or map making service, in relation to location or exploration of deposits of mineral, oil or gas [section 65(104a)]	**Exemptions** • See for general exemptions Study Note - 7

Survey and map-making	**Statutory coverage** • Geological, geophysical or any other prospecting, surface, sub-surface or aerial surveying or map-making of any kind [section 65(104b)]	**Exclusions** • Service provided by an agency under the control of, or authorised by, the Government, in relation to survey and map-making not taxable [section 65(105)(zzzc)] • Survey and exploration of mineral excluded [section 65(104b)] (as covered under another head) **Exemptions** • See for general exemptions Study Note – 7
Technical inspection and certification	**Statutory coverage** • Inspection or examination of goods or process or material or any immovable property to certify that such goods or process or material or immovable property qualifies or maintains the specified standards, including functionality or utility or quality or safety or any other characteristic or parameter [section 65(108)]	**Exclusions** • Service in relation to inspection and certification of pollution levels is excluded [section 65(108)] **Exemptions** • See for general exemptions Study Note - 7
Technical testing and analysis	**Statutory coverage** • Service in relation to physical, chemical, biological or any other scientific testing or analysis of goods or material or any immovable property • Clinical testing of drugs and formulations [section 65(106)] **Case Law/Board Circulars** • Sample collection centers not taxable – *Dr. Lal Path Lab (P) Ltd.* v. *CCE* (2006) 5 STT 171 (CESTAT),	**Exclusions** • Testing or analysis service provided in relation to human beings or animals is excluded. • Testing or analysis for the purpose of determination of the nature of diseased condition, identification of a disease, prevention of any disease or disorder in human beings or animals is not taxable. Medical testing and diagnosis has been excluded from service tax [section 65(106)] **Exemptions** • Testing and analysis of water quality by Government laboratories exempt - Notification No. 6/2006-Service Tax dated 1.3.2006. • Exemption to clinical testing of newly developed drugs - Notification No. 11/2007-ST dated 1-3-2007. • See for general exemptions Study Note - 7

Telecommunication Services	**Statutory coverage** • Service of any description provided by means of any transmission, emission or reception of signs, signals, writing, images and sounds or intelligence or information of any nature, by wire, radio, optical, visual or other electro-magnetic means or systems, including the related transfer or assignment of the right to use capacity for such transmission, emission or reception • voice mail, data services, audio tex services, video tex services, radio paging • fixed telephone services including provision of access to and use of the public switched telephone network for the transmission and switching of voice, data and video, inbound and outbound telephone service to and from national and international destinations • cellular mobile telephone services including provision of access to and use of switched or non-switched networks for the transmission of voice, data and video, inbound and outbound roaming service to and from national and international destinations • carrier services including provision of wired or wireless facilities to originate, terminate or transit calls, charging for interconnection, settlement or termination of domestic or international calls, charging for jointly used facilities including pole attachments, charging for the exclusive use of circuits, a leased circuit or a dedicated link including a speech circuit, data circuit or a telegraph circuit • provision of call management services for a fee including call waiting, call forwarding, caller identification, three-way calling, call display, call	**Exclusions** • Service in relation to on-line information and database access or retrieval, a broadcasting agency or organisation in relation to broadcasting and internet telephony excluded [section 65(109a)] (since covered under another head) **Sale of SIM Card** • In *Bharat Sanchar Nigam Ltd.* v. *UOI* (2006) 3 SCC 1 = 152 Taxman 135 = 3 STT 245 = 282 ITR 273 = 3 VST 95 = 145 STC 91 = AIR 2006 SC 1383 (SC 3 member bench), it has been held that what a SIM card represents is ultimately a question of fact. In determining the issue, the assessing authorities will have to keep in mind the following principles, 'If the SIM card is not sold by the assessee to the subscribers but is merely part of the services rendered by service providers, then a SIM card cannot be charged separately to sales tax. It would depend ultimately upon the intention of parties. If the parties intended that the SIM card would be a separate object of sale, it would be open to the sales tax authorities to levy sales tax thereon. If the sale of SIM card is merely incidental to the service being provided and only facilitates the identification of subscriber, their credit and other details, it would not be assessable to sales tax. In any event, cost of service cannot be included in the value of SIM card by

Tour operator	**Statutory coverage** • 'Tour' means a journey from one place to another irrespective of the distance between such places. • Business of planning, scheduling, organising or arranging tours (which may include arrangements for accommodation, sightseeing or other similar services) by any mode of transport • Business of operating tours in a tourist vehicle covered by a permit granted under the Motor Vehicles Act [section 65(115)] **Case Law/Board Circulars** • In *Praseetha Suresh* v. *CCE* (2007) 8 STT 324 (CESTAT), it was held that the vehicle is required to satisfy specifications as per rule 128 of Motor Vehicle Rules. If these are not satisfied, it is not a tourist vehicle and hence the service is not taxable.	**Exemptions** • In case of package tour, w.e.f. 23-8-2007, service tax is payable on 25% of gross amount charged (Till 22-8-2007, service tax was payable on 40% of gross amount charged) - Notification No. 1/2006-ST dated 1-3-2006 • Tax only on 10% amount when operator only provides booking services - Notification No. 1/2006-ST dated 1-3-2006. • Tax payable 40% in case of other tours - Notification No. 1/2006-ST dated 1-3-2006. • See for general exemptions Study Note - 7
Transport of persons by cruise ships	**Statutory coverage** • Transport of person embarking from any port by a cruise ship. "cruise ship" means a ship or vessel used for providing recreational or pleasure trips.	**Exemptions** • See for general exemptions Study Note - 7

Transport of goods by air	**Statutory coverage** • Transport of goods by aircraft	**Exemptions** • Service of transport of goods is exempt if it is in relation to transport of export goods by aircraft - Notification No. 29/2005-ST dated 15-7-2005. • See for general exemptions Study Note - 7
Transport of goods by road	**Statutory coverage** • Service by a goods transport agency, in relation to transport of goods by road in a goods carriage. • 'Goods transport agency' means any person who provides service in relation to transport of goods by road **and** issues consignment note, by whatever name called [section 65(50b)] **Reverse charge - Person liable for payment of service tax** As per rule 2(1)(d)(v) of Service Tax Rules, Consignor or consignee *who is paying freight* will be liable to pay service tax, if consignor or consignee is any one of the following - (*a*) any factory registered under or governed by the Factories Act, 1948 (63 of 1948). (*b*) any company formed or registered under the Companies Act, 1956 (1 of 1956). (*c*) any corporation established by or under any law. (*d*) any society registered under the Societies Registration Act, 1860 (21 of 1860) or under any law corresponding to that Act in force in any part of India. (*e*) any co-operative society established by or under any law. (*f*) any dealer of excisable goods, who is registered under the Central Excise Act, 1944 (1 of 1944) or the rules made thereunder. (*g*) any body corporate established, or a partnership firm registered, by or under any law.	**Cenvat Credit** • The service receiver should pay tax by GAR-7 challan @ 3.09%. Then, he can avail Cenvat credit of tax so paid by him [Notification No. 1/2006-ST dated 1-3-2006]. **Exemptions** • As per exemption notification No. 13/2008-ST dated 1-3-2008, actually service tax is payable on 25% of gross amount charged from customer by goods transport agency. Thus, service tax payable will be 3% plus 2% education cess plus 1% SAH education cess i.e. total 3.09%. Transport of fruits, vegetables, eggs or milk by road (as exempt under notification 33/2004-ST dated 3-12-2004) • Gross Amount charged on consignments transported in a goods carriage does not exceed Rs. 1,500 (as exempt under clause (i) of notification No. 34/2004-ST dated 3-12-2004) [This is total of all consignments carried in a goods carriage at one time] • Gross Amount charged on individual consignment transported in a goods carriage does not exceed Rs. 750 (as exempt under clause (ii) of notification No. 34/2004-ST dated 3-12-2004). • See for general exemptions Study Note - 7

Transport of goods in containers by rail	**Statutory coverage** • Transport of goods in containers by rail	**Exclusions** • Service provide by Government railway exempt. **Exemptions** • Service tax is payable only on 30% of gross value charged, if Cenvat credit not availed - Notification No. 1/2006-ST, dated 1-3-2006. • See for general exemptions Study Note - 7
Transport of goods (other than water) through pipeline or conduit	**Statutory coverage** • Transport of goods other than water, through pipeline or other conduit	**Exclusions** Transport of water is excluded. **Exemptions** See for general exemptions Study Note - 7
Travel agent (other than air travel agent and rail travel agent)	**Statutory coverage** • Booking of passage for travel other than air travel and rail travel	**Exemptions** See for general exemptions Study Note - 7
Underwriter	**Statutory coverage** • Service in relation to underwriting	**Exemptions** • See for general exemptions Study Note - 7
Video tape production agency	**Statutory coverage** • Process of any recording of any programme, event or function on a magnetic tape or on any other media or device • Services such as editing, cutting, colouring, dubbing, title printing, imparting special effects, processing, adding, modifying or deleting sound, transferring from one media or device to another • Any video post-production activity [section 65(120)]	**Exemptions** • See for general exemptions Study Note - 7

Works Contract Services	**Statutory coverage** "Works contract" means a contract wherein, – *(i)* transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods, **and** *(ii)* such contract is for the purposes of carrying out,- *(a)* erection, commissioning or installation of plant, machinery, equipment or structures, whether pre-fabricated or otherwise, installation of electrical and electronic devices, plumbing, drain laying or other installations for transport of fluids, heating, ventilation or air-conditioning including related pipe work, duct work and sheet metal work, thermal insulation, sound insulation, fire proofing or water proofing, lift and escalator, fire escape staircases or elevators; or *(b)* construction of a new building or a civil structure or a part thereof, or of a pipeline or conduit, primarily for the purposes of commerce or industry; or *(c)* construction of a new residential complex or a part thereof; or *(d)* completion and finishing services, repair, alteration, renovation or restoration of, or similar services, in relation to *(b)* and (c); or *(e)* turnkey projects including engineering, procurement and construction or commissioning *(EPC)* projects **Case Law/Board Circulars** • In *Bharat Sanchar Nigam Ltd.* v. *UOI* (2006) 3 SCC 1 = 152 Taxman 135 = 3 VST 95 = 3 STT 245 = 282 ITR 273 = 145 STC 91 = AIR 2006 SC 1383 (SC 3 member bench), it was held that 'various 'aspects' of transaction can be taxed separately, but sales tax cannot be imposed on service portion and service tax cannot be imposed on value of goods.	**Exclusions** • Works contract in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams, are excluded. **Value of taxable service** • Broadly, two options are available to service provider - (a) Calculate value of service as per rule 2A of Service Tax (Determination of Value) Rules, 2006 (in short 'Valuation Rules) and pay service tax at normal rate @ 12.36% (inclusive of education cess and SAH education cess) on such 'value'. In such case, assessee can avail Cenvat credit of input services, inputs and capital goods (b) Pay service tax under 'composition scheme' at 4.12% of 'gross amount charged for works contract' (inclusive of education cess and SAH education cess), under 'Works Contract (Composition Scheme for Payment of Service tax) Rules, 2007' (the percentage was 2.06% upto 29-2-2008). As per rule 3(2) of Composition Scheme, the assessee cannot avail Cenvat credit of inputs. Thus, the assessee can avail Cenvat credit of input services and capital goods. • In both the cases, Vat / sales tax will not be included in the 'value' for purpose of calculating service tax. **Exemptions** • Construction and works contract services relating to ports exempt, but no exemption to finishing or repairing services - Notification No. 25 / 2007-ST dated 22-5-2007 • See for general exemptions Study Note - 7

	In *Gannon Dunkerley & Co.* v. *State of Rajasthan* (1993) 66 Taxman 229 = 1993 AIR SCW 2621 = (1993) 1 SCC 364 = 88 STC 204 (SC 5 member Constitution bench) it was held that value of goods at the time of incorporation in the works can constitute measure for levy of tax. However, cost of incorporation of the goods in works contract cannot be made part of measure for the levy of tax.	

STUDY NOTE - 9

OVERVIEW OF FOREIGN TRADE POLICY

This Study Note includes

- Background
- Policy Changes Since 1991
- Foreign Trade Policy 2004-09
- Administration of Policy by DGFT
- Import/Export Authorisation
- Export Promotion Councils
- Policy for Import of Goods
- Restriction on Exports

9.1 BACKGROUND

India had for long time adverse balance of payment position in international trade i.e. imports were more than exports; due to which there was shortage of foreign exchange in India. Foreign Exchange Regulation Act was introduced in 1947. This was later replaced with 'the Foreign Exchange Regulation Act, 1973' (FERA) , which came into effect on 1st Jan., 1974 (Now FEMA is in force w.e.f. 1-6-2000].

The policy adopted was to restrict imports by licensing and heavy customs duty on imports.

Import Trade Controls were first introduced in early stages of Second World War by notification under Defense of India Rules. Later, Imports and Exports (Control) Act, 1947 was passed. Foreign exchange rate was artificially controlled by RBI.

India's poor export performance - India's share in total world export of goods and commercial services was 0.6% in 1995. It rose to 0.7% in 2001 and is 1% in 2007. China's share in world exports was 4.3% in 2001 which rose to 8.4% in 2007 [source - Economic Survey 2007-08 - Government of India].

India has adverse balance of trade i.e. imports are more than exports. In 2006-07, imports were 1,85,747 million USD and exports were 1,26,360 million USD.

9.2 POLICY CHANGES SINCE 1991

Government realised the ill effects of controls on imports and foreign exchange rates. Liberalisation of policies started in 1991. Restrictions on imports have been considerably reduced. Rupee has been made freely convertible on current account. Customs duty has been gradually reduced to almost international level.

Policy for Foreign Direct Investment (FDI) in India has been considerably liberalised. India has established a good lead in service exports - particularly in software sector.

Import and export free in majority of cases - As per WTO stipulations, Quantitative Restrictions (QR) on imports (i.e. import licence restrictions) have to be removed. Such restrictions are permitted only if country has difficult position of foreign exchange reserves. However, since India's foreign exchange position is comfortable, European countries, USA, Japan and Canada took a stand that import restrictions must be removed. Finally, India agreed to remove all import restrictions w.e.f. 1-4-2001.

Para 2.1 of FTP states that exports and exports shall be free, except in cases where these are regulated by provisions of FTP or any other law for the time being in force. The item-wise export and import policy shall be as specified in ITS (HS) [Import Trade Classification (Harmonised System)] published and notified by DGFT, as amended from time to time.

Most of non-agricultural goods are freely importable. Even import of gold and silver has been considerably liberalised.

However, there are some restrictions on imports of agricultural produce, old cars etc. There will be prohibition of import of animal skins, narcotics, drugs, environmentally dangerous goods etc. Such prohibitions are permissible under WTO.

FT(D&R) Act in August 1992

Imports and Exports (Control) Act, 1947 was stifling the foreign trade and was a road block. That Act was replaced by the present Foreign Trade (Development and Regulation) Act (FTDR Act) in August 1992.

As per preamble of the FT(D&R) Act, the Foreign Trade (Development and Regulation) Act (FTDR Act) is designed to develop and regulate foreign trade by facilitating imports into India and augmenting exports from India; and for matters connected therewith.

Foreign Trade (Regulation), Rules 1993 have been framed under the FTDR Act. Foreign Trade Policy is announced from time to time under the Act. The Act is designed to authorise Central Government to formulate Export Import policy and change the policy as per changing situations. Authority is granted by Act to Government to implement the policy.

9.3 FOREIGN TRADE POLICY 2004-09

Section 5 of FT(D&R) Act authorises Central Government to formulate and announce Export and Import Policy and also amend the same from time to time, by notification in Official Gazette. The policy, which was earlier termed as Exim policy is now termed as 'Foreign Trade Policy'.

New Foreign Trade Policy for 2004-2009 (FTP) (earlier known as EXIM Policy) was announced on 31-8-2004. The policy is effective from 1-9-2004. Generally, it is amended every year in April (besides amendments done throughout the year). Annual amendments were made last year on 19-4-2007. This year, amended policy has been issued on 11-4-2008.

Contents of Foreign Trade Policy - The Foreign Trade Policy for the period 2004-2009 as announced on 31-8-2004 is a 5 volume document, as follows -

- Foreign Trade Policy having 9 chapters giving basic policy.
- Handbook of Procedures (HBP) Vol 1, containing 9 chapters, covering procedural aspects of policy. It also contains many Appendices, giving various forms, guidelines and lists.
- Vol 2 - Standard Input-Output Norms (SION) of various products for purpose of Duty Exemption Scheme
- ITC(HS) Classifications of Export and Import Items and policy in respect of each item.
- Handbook of DEPB Rates

Matters covered by Foreign Trade Policy

Following issues are covered under FTP -

- Policy for regulating import and export of goods and services.
- Export Promotional Measures
- Duty Remission and Duty Exemption schemes for promotion of exports
- Export Promotion Capital Goods (EPCG) scheme
- EOU / EHTP / STP and BTU schemes
- Special Economic Zones

9.4 ADMINISTRATION OF POLICY BY DGFT

The FTP is controlled and supervised by DGFT.

Central Government can appoint Director General of Foreign Trade (DGFT) and other officers like Additional Director, Joint Director, Deputy Director, Assistant Director, Export Commissioner etc. The DGFT advise Central Government in formulating policy and exercise specified powers under the Act [section 6 of FTDRA].

Handbook of Procedures (HBP) – Para 2.4 of FTP empowers Director General of Foreign Trade (DGFT) to specify procedures to be followed by importer, exporter and licensing authority. Under these powers Handbook (Vol 1 and 2), Schedule of DEPB rates and ITS(HS) are published by Public Notice by DGFT. These are also amended by public notice.

Transitional provisions in case of midway policy changes – Policy in respect of import and import changes frequently. If some restriction or regulation is placed on import or export, shipment of export or import within original validity with respect to balance and time period of irrevocable letter of credit will be permitted, if such LC was established before date of restriction. However, time limit for operationaling such LCs may be prescribed – para 1.5 of FTP.

Issue of authorisation by DGFT – DGFT issues 'authorisation' for import / export [*earlier, it was termed as 'license'*]

The word 'license' has been replaced by 'authorisation' w.e.f. 1-4-2006. Thus, 'Advance License' will be known as 'Advance Authorisation', 'Advance License for Annual Requirements' will be known as 'Advance Authorisation for Annual Requirements' and EPCG license will be known as 'EPCG Authorisation'.

As per para 9.9.1 of FTP, 'Authorisation' means a permission as per section 2(g) of Foreign Trade (Development and Regulation) Act, 1992 [FT(D&R] to import or export as per provisions of Foreign Trade Policy (FTP).

Regional Authority - DGFT has established Regional Authority (RA) [earlier known as Regional Licensing Authority (RLA) upto 31-3-2006] at various places under Joint Director General of Foreign Trade. As per para 9.49.1 of FTP, 'Regional Authority' means authority competent to grant an Authorisation under FTDR Act and Orders. Powers have been delegated to various regional offices to issue authorisation upto prescribed limits.

Interpretation of DGFT final and binding - Decision of Director General of Foreign Trade (DGFT) is final and binding in respect of (a) Interpretation of any provision of policy (b) Classification of any item in ITC(HS) or handbook Vol 1 or 2 (c) Schedule of DEPB rates (d) content, scope or issue of an authorisation issued under Policy. - Para 2.3 of Foreign Trade Policy.

Authorisation (earlier 'License') issued by DGFT or clarification issued by DGFT cannot be challenged by customs authorities. See case law discussed in an earlier chapter.

Committees – Following are some important committees – (i) Norms Committee to fix / modify norms under all schemes (ii) EPCG Committee for nexus with Capital Goods and benefits under EPCG (iii) Policy Relaxation Committee (PRC) for all other issues – para 2.5 of FTP.

Procedures for application, fees etc.

Handbook of Procedures (HBP) gives procedures for issue of authorisation. Objective of 'Handbook of Procedures' is to lay down simple and transparent procedures for easy compliance and administration. The Handbook contains provisions and procedures in respect of various heads under Foreign Trade Policy.

Filing of application forms - Electronic filing of application is permitted in many of the offices. Facility of clarification / interview through e-mail is provided. Digital signature has been introduced to facilitate online application. The website for filing e-application is http: / / dgft.gov.in. [para 2.74 of HBP Vol 1].

Aayat-Niryat form – Aayat Niryat Forms ANF 1 to ANF 8 have been designed and notified for various purposes.

Certificate of realisation of export proceeds – In case of imports made under export obligation, the importer is required to issue certificate from Bank regarding export realisation. The certificate should be in form given in Appendix 22A of HBP Vol 1. In case of domestic supplies, Bank certificate should be in form given in Appendix 22B of HBP Vol 1.

If RBI has permitted offsetting of export proceeds against import payables / equity investment / loan repayment etc., certificate for offsetting export proceeds should in form given in Appen-

dix 22D of HBP Vol 1 to DGFT. The certificate should be duly certified by CA / Cost Accountant.

Payment through ECGC cover will be counted for benefits under FTP – para 2.25.1 of HBP Vol 1 (inserted w.e.f. 1-4-2008).

Payment of general insurance cover for transit loss would be treated as payment realised for exports under various export promotion schemes – para 2.25.2 of HBP Vol 1.

Late fee and supplementary claims – If application is filed after last date for submission but within six months from last date, application will be considered on payment of late cut @ 2% on entitlement. For delay between 6 months and one year, late cut will be 5% – para 9.3 of HBP Vol 1. Supplementary claim may also be considered after imposing a cut @ 2% on entitlement – para 9.4 of HBP Vol 1. (Till 31-3-2008, it was 10%, which was too high).

9.4.1 Import/Export Code Number

Every importer and exporter must obtain a 'Importer Exporter Code Number' (IEC) from DGFT (Director General of Foreign Trade) or officer authorised by him, by applying in prescribed form (section 7 of FT(D&R) Act).

Import and export without IEC number is not permitted, unless specifically exempted [para 2.12 of FTP].

Application for IEC number - Application for IEC number has to be made to DGFT in prescribed form ANF 2A, with fees of Rs. 250 (It was Rs 1,000 upto 11-4-2008).

Format of bank certificate is given in Appendix 18A of HBP Vol 1. Profile of importer / exporter should be given in form ANF 1.

Declaration of IEC number on import/export documents – IEC number will be declared on Bill of Entry, Shipping Bill and other documents relating to customs [Rule 13 Foreign Trade (Regulation) Rules, 1993].

Application for IEC number has to be made to DGFT in prescribed form with specified documents, with fees of Rs. 1,000 in prescribed form.

Change in name, address and Constitution – Change in name / address / constitution should be incorporated within 90 days. Delay may be condoned on payment of penalty of Rs 1,000 – para 9.1 of HBP Vol 1.

9.5 IMPORT/EXPORT AUTHORISATION

Application for licence for import or export has to be made to DGFT. Application fees are payable as prescribed. [section 8(1) of FT(D&R) Act].

Licence can be granted or refused. Refusal can be only by recording reasons in writing [section 8(2) of FT(D&R) Act].

Licence can be suspended or cancelled by giving notice and giving him opportunity of being heard.

If licence is refused, not renewed, suspended or cancelled, appeal against such order can be filed u/s 15 of FT(D&R) Act [section 9(5) of FT(D&R) Act].

Application for authorisation is to be made in form ANF 2B for import of restricted items, and in form ANF 2D for export of restricted items and ANF 2E for export of SCOMET items.

Two copies of authorisation - Authorisation (earlier termed as License) is issued in two originals - one is 'Exchange Control Copy' (which has to be submitted to bank for remitting foreign exchange) and other 'Customs Copy' to be submitted to customs authorities for permitting imports.

Denomination of import authorisation and EO – CIF value of Import authorisation and FOB value of Export Obligation (EO) will be denominated in free foreign currency as well as in Rupees. However, control will be on basis of foreign exchange amount and not on basis if Rupees. Export Obligation in case of intermediate supply and for deemed export shall be denominated in Indian Rupees – para 9.2 of HBP Vol 1.

Application fees for authorisation - Application fees payable are prescribed in Schedule to Foreign Trade (Regulation) Rules, 1993. Fee is not payable if application is by Government, local authority, institutions setup for educational, charitable or missionary purpose for import of goods, or import of goods (other than motor vehicle) for personal use - [rule 5(3) of Foreign Trade (Regulation) Rules, 1993].

9.6 EXPORT PROMOTION COUNCILS

19 Export Promotion Councils have been set up to promote and develop export of the country. These EPCs (Export Promotion Councils) are expected to monitor and encourage exports and to assist and guide the exporters. Their main aim is to project India's image abroad as a reliable supplier of high quality goods and services.

EPC are non-profit autonomous organisations – para 2.65 of HBP Vol 1.

Each Council is responsible for promotion of a particular group or products like Engineering Export Promotion Council, Apparel Export Promotion Council, Gem and Jewellery Export Promotion Council etc. These Councils are non-profit organisations registered as Companies or registered Societies.

Export Promotion Council for EOU and SEZ units has also been constituted.

Some Agencies like Coffee Board, Tea Board, Tobacco Board etc. are also considered as Export Promotion Councils. These are autonomous professional bodies. Government may provide financial support to these EPCs [para 2.65 of HBP Vol 1].

Services Export Promotion Council – Services Export Promotion Council has been established at 705, Bhikaji Cama Bhawan, Bhikaji Cama Place, New Delhi – 110 066. email – epces@vsnl.net.

RCMC - Exporter has to obtain Registration Cum Membership Certificate (RCMC) from Export Promotion Council or Commodity Board. Membership of EPC is compulsory, if an exporter intends to get export incentives. In other cases, membership is optional.

RCMC is valid from the 1st April of licensing year and is valid for five years –

Exporter should submit quarterly export returns to Export Promotion Council in Appendix 149C of HBP Vol 1. Status holders should also file return with FIEO – – para 2.70 of HBP Vol 1.

9.7 POLICY FOR IMPORT OF GOODS

As per WTO Stipulation, India had to remove all quantitative restrictions (QRs) on imports in phased manner. Hence, the imports were being liberalised every year and import restrictions were completely lifted on 1-4-2001. Now almost all non-agricultural items are freely importable.

Import free unless restricted or prohibited - Para 2.1 of FTP states that exports and exports shall be free, except in cases where these are regulated by provisions of FTP or any other law for the time being in force. The item-wise export and import policy shall be as specified in ITS (HS) [Import Trade Classification (Harmonised System)] published and notified by DGFT, as amended from time to time.

All items, except restricted, prohibited and importable through State Trading Enterprises (earlier termed as canalised items) can be freely imported [Items which could be freely imported were earlier termed as 'OGL' *i.e.* 'Open General Licence'].

ITC(HS)

The ITC (HS) [Import Trade Classification (Harmonised System)] notified by DGFT, gives itemwise policy for import of various articles para 2.1 of FTP].

The list is based on HSN system of classification (which is also followed in Customs Tariff Act]. Policy in respect of each item is given against each item, in following categories –

(a) Free – no restriction on imports (However, in some cases, prescribed conditions have to be fulfilled)

(b) Prohibited goods

(c) Restricted through authorisation or in terms of a public notice issued [para 2.7 of FTP]

(d) Importable through State Trading Enterprises (STE) (earlier terms as Canalised). However, these goods can be imported by anyone on obtaining Authorisation from DGFT [para 2.11 of FTP].

General restrictions – General prohibitions / restrictions on import / export are as follows –

- Import / export of arms and related material from / to Iraq [para 2.1.1 of FTP]
- Direct or indirect export and import of nuclear related or weapons of mass destruction from / to Democratic People's Republic of Korea [para 2.1.2 of FTP]

- Direct or indirect export and import of nuclear related or Iran's enrichment related or heavy water related activities [para 2.1.3 of FTP]

Restriction through notification by DGFT – DGFT can adopt and enforce any measure necessary for protection of public morals, protection of health, protection of IPR, conservation of natural resources etc., by issuing a notification [para 2.6 of FTP].

Actual User - If the import authorisation or licence is required, it is issued only to Actual User, unless the condition is specifically waived by RA (Regional Authority) [para 2.16 of FTP].

'Actual User' may be Industrial on non-industrial [para 9.4 of FTP].

The Actual User (Industrial) means a person who utilises the imported goods for manufacturing in his own industrial unit or manufacturing for his own unit in another unit including a jobbing unit [para 9.5 of FTP]. [Thus, actual user can supply the machinery / raw material etc. to other unit for manufacture on job work basis].

Actual User (Non Industrial) means a person who utilises imported goods for commercial establishment, laboratory, R&D Institution, University, educational institution or any service industry [para 9.6 of FTP].

In *Northern Plastics Ltd.* v. *CCE* 1998 AIR SCW 2355 = AIR 1998 SC 2371, it was held that a registered SSI unit can be an 'actual user'.

Transfer of goods imported under Actual User condition – Goods imported with Actual User condition can be transferred with prior permission of Regional Authority. Application giving details as prescribed in para 2.43 of HBP Vol. 1 should be made.

Broad Policy for import of goods

Broad outline of policy is as follows -

- Import of agricultural products like wheat, rice, maize, other coarse cereals, copra and coconut oil will be in State Trading category. Similarly, import of petroleum products including petrol, diesel and ATF will be in the category of State Trading. Urea will also be in State Trading.
- Import of Food Articles will be subject to compliance of provisions of Food Adulteration Act and Rules. Import of meat and poultry products will comply with provisions of Meat Food Product Order. Import of Tea Waste will be as per Tea Waste (Control) Order. Import of beef or even oils and food products containing beef is prohibited.
- Import of textile material using prohibited dyes like azo dyes is not permitted.
- New cars can be imported only from country of manufacture. They should comply with provisions of Central Motor Vehicle Rules. They should be right hand drive, with speedometer in KM. Import is permitted only through specified ports. Customs duty on new cars (CBU – Completely Built Units) has been kept high to discourage imports.

- Import of alcoholic beverages (liquor) will be as per mandatory requirements stipulated by State Governments.
- Second hand capital goods (except computers) are freely permitted without actual user condition. Thus, even traders can import and sale second hand capital goods Duty can be paid through DEPB credit.

Prohibited Items - Wild animals, their parts, ivory, tallow, fats or oils of animal origin, fish nail/tail/waste, pig fats, margarine of animal origin, degras, mutton tallow, chicory plants, and animal rennet are prohibited goods for obvious reason of saving wild life. These cannot be imported even on obtaining an 'authorisation'.

Second hand goods – Second hand capital goods including refurbished/reconditioned spares are freely permitted. Other second hand goods are restricted. Import of second hand PC, laptop, air conditioner, DG set, photocopier will require authorization. Import of re-manufactured goods will also require authorisation [para 2.17 of FTP].

Import of gold & silver – Import of silver and gold and coins is free subject to RBI regulations.

Import only through State Trading Enterprises - Some items should be imported only through State Trading Enterprises [earlier termed as 'Canalised items' upto 31.3.2001]. (*a*) Petroleum Products can be imported only through Indian Oil Corporation (*b*) Urea only through STC, MMTC and Indian Potash Ltd. (*c*) Wheat, maize, rice etc. Food Corporation of India (FCI) *(d)* Copra and crude oil – STC.

Users in India who require these goods have to register their indent with the canalising agency. Normally, the goods are released to only actual users. After the quota of goods is released in the favour of indentor, payment should be made within the stipulated period and delivery should be taken. Otherwise, the allotted quota lapses.

Import on export basis – New or second hand capital goods, equipments, components, parts, containers, jigs, fixtures, tools, moulds, dies etc. can be imported for export without an authorisation, if item is freely importable. A bond or bank guarantee for its re-export has to be submitted to Customs Authorities [para 2.21 of FTP].

Repairs abroad and re-import - Capital goods or their parts (whether imported or indigenous) can be sent abroad for repairs, testing or upgradation and re-imported without authorisation (licence) [para 2.22 of FTP].

Import of gifts - Import of gifts is permitted when goods are freely importable. In other cases, Customs Clearance Certificate (CCP) from DGFT will be required [para 2.19 of FTP]. Gifts upto Rs 10,000 are exempt from customs duty.

Import of metallic waste and scrap – The metallic scrap should not contain hazardous, toxic waste, radio active material, arms, ammunition, mines, shells, cartridge or explosive material [para 2.32.1 of HBP Vol 1].

Import of steel, cast iron, copper, brass, Nickel, Aluminium, Zinc, Tin and Magnesium scrap is free subject to prescribed conditions. Pre-shipment inspection can be prescribed. Import will

be permitted through specified ports only [para 2.32.2 of HBP Vol 1]. Import of other metallic scrap will be allowed only as per conditions given in ITC (HS) – para 2.32.2 of HBP Vol 1].

Pre-shipment inspection can be prescribed for this purpose. List of Inspection and Certification Agencies is given in Appendix 5 of HBP Vol. 1 Part II.

Import of live stock and live stock products, poultry products – Import of live-stock and live-stock products is prohibited in view of Aviation Influenza [para 16 of part 1, Schedule 1 of General Notes to ITC (HS)].

Samples upto Rs 1,00,000 (Rs 3,00,000 for gem and jewellery sector) can be imported by all exporters without duty – para 2.27 of HBP Vol. 1 as amended w.e.f. 1-4-2008.

Samples in baggage - Commercial samples are not treated as '*bona fide*' luggage. Its import is as per provisions of Foreign Trade Policy as applicable to normal imports of commercial goods. These should be declared before customs officers at the time of arrival. [*New Delhi Commissionerate TN 12/96 dated 15-2-1996*]. The commercial samples are exempt from duty only to the extent explained below.

Small commercial samples and protopypes – *Bona fide* samples and prototypes upto Rs. 10,000 are exempt from customs duty, if imported by post or in aircraft or by courier service. While calculating vale of samples / prototypes, postal charges or airfreight are not considered. - Notification No. 154/94-Cus dated 13-7-1994.

9.8 RESTRICTIONS ON EXPORTS

Restrictions on exports are less compared to restrictions on imports. The Policy gives negative list of exports. This negative list is under three headings (*a*) Prohibited goods (*b*) Restricted through Authorisation (*c*) State Trading Enterprises [earlier termed as canalised].

Third party exports – Third party exports means exports made by an Exporter or Manufacturer on behalf of another exporter/s. The Shipping Bill shall indicate the names of both the exporter/manufacturer and exporter. The BRC, GR declaration, export order and the Invoice shall be in name of the third party exporter [para 9.62 of FTP and CBE&C circular No. 30/2005-Cus dated 12-7-2005].

Merchant Exporter – Merchant Exporter means a person engaged in trading activity and exporting or intending to export goods [para 9.40 of FTP].

General restrictions – General prohibitions/restrictions on import/export are as follows –

- Import/export of arms and related material from/to Iraq [para 2.1.1 of FTP]
- Direct or indirect export and import of nuclear related or weapons of mass destruction from/to Democratic People's Republic of Korea [para 2.1.2 of FTP]
- Direct or indirect export and import of nuclear related or Iran's enrichment related or heavy water related activities [para 2.1.3 of FTP]

Restriction through notification by DGFT – DGFT can adopt and enforce any measure necessary for protection of public morals, protection of health, protection of IPR, conservation of natural resources etc., by issuing a notification [para 2.6 of FTP].

Prohibited goods for export - Wild life including their products and parts, exotic birds, endangered plants, beef, pig fat, carcasses of buffalo, certain rock lobsters, meat and bones of wind animals, milk, skimmed milk, milk food for babies, peacock feathers and handicrafts of peacock feathers, dried leguminous vegetables, guar seeds, lentils, wheat and meslin, specified plant and plant portions, sea weeds, tallow / flat / oil of any animal origin excluding fish oil, sugar, sea shells, ivory, bovine semen, potato seeds, seeds, margarine of animal origin, human skeletons, wood and wood products, wood pulp, sandalwood and red sanders wood are prohibited.

Thus, items related to conservation of our natural resources, are mainly prohibited.

Export of personal luggage - *Bona fide* personal luggage can be exported either with passenger or one year before or after his departure from India. Export of items in negative list will require licence or authorisation [para 2.32 of FTP].

Export of gifts - Gifts upto Rs. 5,00,000 can be exported without authorisation. These can include edible items [para 2.32 of FTP].

For export of gifts / spares / replacement goods in excess of ceiling / period, application can be made to DGFT – para 2.53 of HBP Vol 1.

Exports of warranty spares and replacement - Warranty spares of plant, machinery etc. can be exported without authorisation along with the main equipment or subsequently within warranty period, subject to approval of RBI [para 2.33 of FTP]. [It is not clear why this new hurdle is created when we are talking of more and more liberalization].

If goods exported were found to be defective / damaged or otherwise unfit] can be replaced free of charge by exporter. Such replacement is allowed provided the replacement goods are not under restricted category – para 2.37 of FTP.

For export of gifts / spares / replacement goods in excess of ceiling / period, application can be made to DGFT – para 2.53 of HBP Vol 1.

SCOMET Items - Export of Special Chemicals, Organisms, Materials, Equipment and Technologies (SCOMET) is either prohibited or restricted. These cover nuclear material, nuclear reactors, equipment for nuclear explosive devises, rocket systems, toxic chemicals, micro-organisms, chemicals for weapons, viruses, etc.

Application for license for exporting these items is to be made to DGFT. Application will be considered by Exim Facilitation Committee (EFC). In respect of items specified in Appendix 3 to Schedule 2 of ITC(HS), application will be considered by Inter-Ministerial working group in DGFT based on criteria as specified in para 2.50 of FTP.

On export of SCOMET items, the end use is required to issue certificate in form given in Appendix 36 of HBP Vol 1.

General System of Preferences (GSP) – Under this scheme, industrialized i.e. developed countries extend tariff concessions to developing countries on unilateral basis. USA, EOU, Japan, Australia, Russia etc. Provide such concessions. Information is required to be submitted in prescribed form and is to be certified by authorised agencies. List of agencies authorised to issue GSP CoO (Certificate of Origin) is given in Appendix 4A of HBP Vol. 1 Part II – para 2.21.1 of HBP Vol. 1.

Global System of Trade Preference (GSTP) – Under this scheme, tariff concessions are exchanged among developing countries who have signed agreement. Some 46 countries are members of GSTP. India has exchanged tariff concessions with few countries in respect of some products. Certificate of Origin (CoO) is required to be obtained from Export Inspection Council [EIC] – para 2.21.1 of HBP Vol. 1.

SAARC Preferential Trading Agreement (SAPTA) – SAPTA came into operation in 1995. More than 3,000 tariff items are under tariff concessions. Certificate of Origin (CoO) is to be obtained from agencies as notified in Appendix 4B of HBP Vol. 1 Part II.

Asia-Pacific Trade Agreement (APTA) – Bangladesh, Sri Lanka, South Korea, India and China are exchanging tariff concessions under APTA - . Certificate of Origin (CoO) is required to be obtained from Export Inspection Council [EIC] – para 2.21.1 of HBP Vol. 1.

STUDY NOTE - 10

Export Promotion Schemes

This Study Note includes

- Background
- Duty Drawback
- EOU and Similar Schemes
- Special Economic Zones
- Advance Authorisation
- Duty Entitlement Pass Book Scheme(DEPB Scheme)
- Duty Free Import Authorisation
- EPCG Authorisation

10.1 BACKGROUND

- **Basic concept is that goods and services are to be exported, taxes are not to be exported.**
- **As per WTO stipulations, export incentives cannot be given, but exported goods can be made tax free.**
- **Various scheme have been devised to enable exporters to obtain inputs without payment of excise and customs duty and input services without payment of service tax. If tax paid, rebate can be obtained.**
- **Goods can be exported without payment of excise duty. If excise duty is paid, refund can be obtained.**

Broadly, the export incentives for manufacturers are -

(a) Indigenous inputs without payment of excise duty or rebate if duty paid

(b) No excise charged on final product or rebate if duty paid

(c) Imported inputs without payment of customs duty, or rebate if duty paid

(d) No export duty on export of final product

(e) Bank finance on priority basis and at concessional rate of interest

(f) Import of capital goods at concessional rate (under EPCG scheme)

(g) Exemptions / relaxations from Income tax

(h) Exemption from sales tax on final product (refund of CST paid on inputs in case of EOU. No CST for supply to SEZ and SEZ units)

(i) Usance bills of exchange executed by an exporter in relation to export transaction are fully exempt from stamp duty – SO 804(E) dated 8-7-2004.

WTO stipulation - As per stipulation of World Trade Organisation (WTO), no country can give 'export incentives' as such. The reason is that WTO intends to encourage free competition among nations. If incentives are given for exports, there will not be free competition. That is the reason why income-tax incentives on export income are being phased out. However, goods can be made tax-free for export purposes, which is permissible under WTO stipulations. Hence, all our export promotion schemes are directed towards ensuring that inputs as well as final products are made 'tax free'.

10.1.1 Input duty relief schemes

Various schemes have been devised to obtain inputs free from duty or to grant refund of the same. In some schemes, the unit has to be isolated from domestic production units, while in some schemes, the units producing goods for domestic production are also entitled to get inputs free of cost.

Schemes where export production unit has to be isolated from domestic production units - There are schemes where units producing goods for export purposes have to be isolated from domestic units. The schemes are - EOU, STP, EHTP, BTP and SEZ. [BTP – Bio-Technology Park]

Schemes where domestic production unit can get inputs free from taxes - The schemes of EOU, SEZ, STP, BTP and EHTP are suitable where the unit is exclusively or at least predominantly for export purposes. There are other schemes where a unit producing goods for domestic purposes is also entitled to get inputs / capital goods without payment of customs duty / excise duty. These can be broadly classified as follows.

Relief of excise duty on inputs – (a) Cenvat credit of duty paid on inputs can be utilised for payment of excise duty on other final products. Alternatively, refund of duty paid on inputs can be obtained (b) Same result can be achieved by paying duty on final product and claiming rebate. In this case, additional benefit is that duty paid on capital goods will also get refunded indirectly. In first case, only duty paid on inputs is refundable (c) Obtaining inputs without payment of excise duty under notification No. 43/2001-CE(NT). This is advisable when there are one or two major identifiable inputs (d) Rebate of duty paid on inputs under notification No. 41/2001-CE(NT) (e) Excise portion of Duty drawback.

Relief of customs duty on inputs – (a) Advance Authorisation (b) Duty Entitlement Pass Book scheme (DEPB) (c) DFIA (d) Customs portion of duty drawback.

Capital goods at concessional rate - Capital goods can also be obtained at concessional rate of customs duty under EPCG scheme.

It should be noted that an exporter can get relief only once. He cannot get double benefit.

10.1.2 Highlights of EOU/SEZ scheme

The highlights of EOU (Export Oriented Unit) and SEZ (Special Economic Zone) and distinctions are as follows –

Distinctions

- Supplies to SEZ from DTA are 'exports' while supplies to EOU from DTA are 'deemed exports'.
- SEZ unit has to be located within the specified zones developed, while EOU unit can be set up at any of over 300 places all over India. [Similarly, STP/EHTP/BTP unit can be situated within the zone specifically developed or at any place where EOU can be set up]
- There is physical control over movement of goods in Special Economic Zone, but there is no such physical control over goods to individual EOU.
- Minimum investment in plant and machinery and building is Rs 100 lakhs for EOU. This should be before commencement of commercial production. There is no such limit for SEZ.
- Fast Track Clearance Scheme (FTCS) for clearances of imported consignments for EOU. In case of SEZ units, customs clearance for export and import is obtained within the zone itself.
- In case of EOU, sale within India should be on payment of excise duty. In certain cases, excise duty payable will be only 50%/30% of normal customs duty payable on such goods if imported into India. In case of supplies from SEZ to Domestic Tariff Area, normal customs duty as payable on import of similar goods is payable.
- EOU unit can sale in DTA (Domestic Tariff Area) sale upto 50% of the FOB value of sales of preceding year, subject to fulfilment of positive NFE, on payment of concessional rate of duty. There is no such restriction in case of SE on percentage, but SEZ have to attain positive NFE.
- Restrictions under Companies Act on managerial remuneration are not applicable to SEZ units.
- The unit can exit (de-bond) with permission of Development Commissioner, on payment of applicable duties. However, in case of SEZ, the unit has to physically go out of SEZ. This is not the case of EOU.
- In case of EOU, Central Sales Tax (CST) paid on purchases is refundable (but not local tax), if goods are used for production (and not for services). In case of SEZ unit, supplier does not have to pay CST.
- Service tax is exempted in case of services provided with SEZ. In case of EOU, service tax exemption is not available but they can claim refund.
- 100% foreign equity is permissible in SEZ, except in a few cases. In case of EOU, restrictions of Foreign Direct Investment (FDI) are slightly more.

- Supplies made to EOU by Indian supplier are 'deemed exports' and supplier is entitled to benefits of 'deemed export' in form of refund of terminal excise duty and duty drawback. Supplies to SEZ are 'exports' and all export benefits i.e. DEPB and duty drawback are available.
- Restrictions on External Commercial Borrowings are less in case of SEZ, compared to restrictions on EOU.
- No exemption from labour laws, but State Government can relax certain provisions of labour laws in case of SEZ.
- SEZ are is specific locations where infrastructure is generally better.
- SEZ have more freedom of operations within zone compared to EOU.

Similarities

- The unit can import capital goods, raw materials, consumables, packing material, spares etc. without payment of customs duty. Similarly, these can be procured indigenously without payment of excise duty. Second hand capital goods can also be imported.
- They have to achieve positive NFE (Net Foreign Exchange Earnings).
- A bond in prescribed form has to be executed. [B-17 in case of EOU and form prescribed in Special Economic Zone Rules, 2003 in case of SEZ]. There is no physical supervision of customs / excise authorities over production and clearances, but prescribed records are required to be maintained.
- Generally, all final production should be exported, except rejects upto prescribed limit.
- Sub-contracting of production outside on job work basis is permissible after obtaining necessary permission on annual basis
- Job work for exports is permitted
- Samples can be sold / given free within prescribed limit
- Unutilised raw material can be disposed of on payment of applicable duties
- all foreign exchange earnings can be retained in EEFC account in foreign exchange.

STP / EHTP/BTP unit – Concept of STP / EHTP / BTP is similar to EOU. The STP / EHTP scheme is administered by Ministry of Information Technology, while BTP scheme is monitored by Department of Biotechnology. The STP / EHTP / BTP unit can be at a place specifically developed for the purpose or it can be located at any place where EOU can be set up. Thus, a STP / EHTP / BTP unit can be set up as an EOU unit anywhere in India or as a SEZ unit at specified developed locations in India.

10.1.3 Pros and cons of various schemes

It is true that no one scheme can be suitable to all. Each manufacturer has to weigh *pros* and *cons* of each scheme and determine which scheme is most beneficial to him.

Generally, if major production of the company is towards sale in DTA (Domestic Tariff Area) and only partly towards export, schemes like DEPB or DFRC or advance authorisation are suitable. Other things being equal, scheme of duty drawback is simple and easy to operate particularly when All Industry Rate fixed is good.

Schemes like EOU (Export Oriented Unit) / SEZ (Special Economic Zones) are suitable (a) when the undertaking is predominantly export oriented (b) Requirement of imported capital goods and imported raw material is high. EOU has lost most of its attractive features and recently, EOUs are getting step-motherly treatment from Government, while SEZ is 'favoured baby'.

10.2 DUTY DRAWBACK

- Duty drawback is rebate of excise duty and customs duty paid on inputs used in exported final product u / s 75 of Customs Act.
- All Industry drawback rate is fixed on industry average basis for various products. Incidence of service tax is also taken into account while fixing drawback rate.
- An individual exporter can get brand rate fixed for his product.
- Drawback rate is fixed by Commissioner of Central Excise.
- Duty drawback is available on re-export u / s 74 of Customs Act.

Drawback of customs and excise duty paid on inputs and service tax paid on input services – As per rule 2(a) of Customs, Central Excise Duties and Service Tax Drawback Rules, 1995, Drawback, in relation to any goods manufactured in India and exported, means the rebate of duty or tax, as the case may be, chargeable on any imported materials or excisable materials used or taxable services used as input services in manufacture of such goods [reference to service tax was inserted w.e.f. 13-7-2006]. 'Input service' has same meaning as assigned to it in Cenvat Credit Rules, 2004 [rule 2(da) of Drawback Rules, 1995].

As per para 9.22 of FTP, Drawback, in relation to any goods manufactured in India and exported, means the rebate of duty chargeable on any imported materials or excisable material used in manufacture of such goods in India. The goods include imported spares, if supplied with capital goods manufactured in India.

Duty Drawback even if CVD paid through DEPB – Duty drawback of CVD is available even when CVD is paid through DEPB credit – MF(DR) circular No. 41 / 2005-Cus dated 28-10-2005.

10.2.1 Drawback – When not eligible

Section 75 of Customs Act, 1962 provide some disallowances or cases when drawback allowed can be recovered. Further, section 76(2) of Customs Act, 1962 authorises Central Government

to issue notifications prohibiting drawback if the goods are likely to be smuggled back to India after export. Drawback Rules also provide for some disallowances. These are summarised below :

- If sale proceeds of export goods are not received within time stipulated by RBI [This provision does not apply to goods supplied from DTA unit to SEZ unit]
- If no customs / excise duty is paid on the inputs or service tax is not paid on input services
- If imported inputs were obtained under Advance License (DEEC scheme) without payment of duty
- If importer avails DEPB or DFRC
- Goods manufactured under Customs Bond or Excise Bond where inputs were obtained without payment of duty
- Goods manufactured by EOU or a unit in Special Economic Zone (as they obtain inputs without payment of duty)
- If Cenvat was claimed on indigenous inputs. [In such case, excise portion of duty drawback will not be available].
- In case of negative value addition – i.e. selling price of exported goods is less than value of imported goods i.e. foreign exchange spent on import of raw material is more than FOB Value of exports.
- Jute batching oil used in manufacture of jute yarn, twist, twine etc.
- Packing materials used in relation to export of jute yarn, jute fabrics and jute manufacture.
- Where specific rates are provided, drawback will not be paid if it is less than 1% of FOB Value of the product, unless drawback claim per shipment is over Rs. 500 – para 11 of Notification No. 81 / 2006-Cus(NT) dated 13-7-2006 [earlier Notification No. 36 / 2005-Cus(NT) dated 2-5-2005].
- If wholesale market price of goods in India is less than the amount of drawback due.
- Exports to Nepal / Bhutan. However, exports to Nepal are eligible if payment is received under hard currency i.e. dollars, euro, Yen British pounds etc.
- No drawback of sales tax, octroi or other taxes – drawback is of customs and Central Excise duties *only*.
- Export of alcoholic liquor, cigarettes, cigar and pipe tobacco; *as stores*; to foreign going vessel of less than 200 tons.
- If goods exported by vessel of less than 1,000 tons; unless certificate is submitted that sale

proceeds in foreign currency have been received and goods have landed at destination within three months.

- If drawback is less than Rs. 50.

Broadly, drawback is not allowed if excise/customs duty or service tax has not been paid on inputs or manufacturer has availed some other benefit in respect of duty paid on inputs or input services. Principle is that there cannot be double benefit.

10.2.2 Type of Drawback Rates

Duty drawback rates are of following types – (a) All Industry Rate (b) Brand Rate and (c) Special Brand Rate.

All Industry Drawback Rates - All Industry Drawback rates are fixed by Directorate of Drawback, Dept. of Revenue, Ministry of Finance, Govt. of India, Jeevan Deep, Parliament Street, New Delhi – 110 001. The rates are periodically revised – normally on 1st June every year. Data from industry is collected for this purpose.

Whenever specific rates are provided, drawback shall be payable only if amount is more than 1% of FOB value, except when the drawback claim per shipment exceeds Rs 500. Revised rates have been announced vide Notification No. 68/2007-Cus(NT) dated 16-7-2007 [earlier Notification No. 81/2006-Cus(NT) dated 13-7-2006].

The all industry drawback rates are given in two ways – (a) when Cenvat facility has been availed and (b) when Cenvat facility not availed. The difference between the two is central excise portion of duty drawback. If rate indicated in both is same, it means that it pertains to only customs portion and is available irrespective of whether exporter has availed Cenvat or not – Condition No 5 to Notification No. 68/2007-Cus(NT) dated 16-7-2007 [earlier No. 81/2006-Cus(NT) dated 13-7-2006].

Duty drawback rate shall not exceed 33% of market price of export goods (Rule 8A w.e.f. 15-2-2006).

In case of some cases, value cap has been fixed. In such cases, maximum drawback allowable per unit of quantity has been specified (This is to avoid misuse by over-valuation of export goods].

Brand Rate of duty drawback – It is possible to fix All Industry Rate only for some standard products. It cannot be fixed for special type of products. In such cases, *brand rate* is fixed under rule 6. The manufacturer has to submit application with all details to Commissioner, Central Excise. Such application must be made within 60 days of export. This period can be extended by Central Government by further 30 days. Further extension can be granted even upto one year in if delay was due to abnormal situations as explained in MF(DR) circular No. 82/98-Cus dated 29-10-1998.

Duty drawback rate shall not exceed 33% of market price of export goods (Rule 8A w.e.f. 15-2-2006).

Special Brand Rate of duty drawback – All Industry rate is fixed on average basis. Thus, a particular manufacturer or exporter may find that the actual excise/customs duty paid on inputs or input services is higher than All Industry Rate fixed for his product. In such case, he can apply under rule 7 of Drawback Rules for fixation of Special Brand Rate, within 30 days from export. The conditions of eligibility are (*a*) the All Industry Rate fixed should be less than 80% of the duties paid by him (*b*) rate should not be less than 1% of FOB value of product except when amount of drawback per shipment is more than Rs. 500 (*c*) export value is not less than the value of imported material used in them – i.e. there should not be '*negative value addition*'.

10.2.3 Drawback Rate Fixation

Forms and procedures have been prescribed for submitting details to jurisdictional Commissioner of Central Excise, who will fix the rate of duty drawback. [Earlier, it was done by Director of Drawback, New Delhi, upto 31-3-2003]. Manufacturer has to make application for fixation of duty drawback rate. Application for fixation of rate has to be filed to Commissioner of Central Excise within 30/60 days of export. [60 days in case of brand rate and 30 days in case of special brand rate]. This period can be extended by him upto further 30 days in exceptional and genuine cases, for which a special request should be made.

10.2.4 Drawback claim procedure

At the time of export, exporter shall endorse on the 'shipping bill' the description, quantity and other details to decide whether goods are eligible for duty drawback. He should submit one extra copy of shipping bill for drawback purposes. Copy of Invoice should be submitted.

If shipping bill under drawback is submitted electronically, that itself will be treated as claim for drawback [rule 13(5) of Drawback Rules amended w.e.f. 13-7-2006].

Declaration by Exporter – A declaration should be made rule 12(1)(a)(ii) of Duty Drawback Rules, on shipping bill or bill of export that claim of drawback. Further declarations are also required when brand rate or special brand rate has been fixed. These declarations have to be signed by exporter.

Forms of declarations for claiming All Industry Rates have been given in CC, Mumbai PN 10/2005-Cus dated 16-3-2005 [182 ELT T12].

Triplicate copy of Shipping Bill is the drawback copy and should be marked as 'Drawback Claim Copy'. It should be submitted with pre-receipt on reverse side with revenue stamp.

Declaration for non-availment of Cenvat – (a) If the manufacturer-exporter or supporting manufacturer of merchant exporter is registered with Central Excise, fact of non-availment of Cenvat credit can be verified from ARE-1 form furnished (b) If the manufacturer-exporter or supporting manufacturer of merchant exporter is not registered with Central Excise, they have to submit self-declaration about non-availment of Cenvat in prescribed form. – MF(DR) circular No. 8/2003-Cus dated 17-2-2003.

10.2.5 Duty drawback on Re-export

Section 74 of Customs Act, 1962 provide for drawback if the goods are re-exported as such or after use. This may happen in cases like import for exhibitions, goods rejected or wrong shipment etc. The re-exported goods should be identifiable as having been imported and should be re-exported within two years from date of payment of duty when they were imported. This period (of two years) can be extended by CBE&C on sufficient cause being shown. These should be declared and inspected by Customs Officer. Original shipping bill under which the goods were imported should be produced. The goods can be exported as cargo by air or sea, or as baggage or by post. - . - . – After inspection, export and submission of application with full details, 98% of the customs duty paid while importing the goods is repaid as drawback.

Section 74 is applicable when imported goods are re-exported as it is and article is easily identifiable, while section 75 is applicable when imported materials are used in the manufacture of goods which are then exported – *ABC India Ltd.* v. *UOI* 1992(61) ELT 205 (Del HC).

10.3 EOU AND SIMILAR SCHEMES

Key Points

- EOU scheme enables a manufacturer to import inputs without payment of customs duty and export final products.
- EOU should have positive NFE (Net Foreign Exchange Earning).
- They have to execute B-17 bond. Indigenous goods can be obtained without payment of excise duty by submitting CT-3 certificate.
- EOU can sale in DTA (Domestic Tariff Area) upto 50% of FOB value of their previous year's exports.
- Scheme of STP (Software technology Park), EHTP (Electronic Hardware Technology Park and BTP (Bio Technology Park) are similar to EOU.
- EOUs are presently getting step motherly treatment from Government.

10.4 SPECIAL ECONOMIC ZONES (SEZ)

SEZ is as if it is a separate island as if outside India, where inputs, capital goods and input services can be obtained without duty and service tax. SEZ are governed by Special Economic Zones Act and SEZ Rules. Supplies to SEZ from India is 'exports' and supplies from SEZ to DTA (Domestic Tariff Area) is 'import'.

SEZ are like a separate island within country. These are treated as if they are outside India for customs purposes. Goods can be brought in SEZ without payment of customs duty or excise duty. Supplies to SEZ from other parts of India are treated as 'exports' and are entitled to all export benefits. On the other hand, supplies from SEZ unit to any person outside SEZ is treated as 'import' by that person and normal customs duty is payable.

SEZ have full freedom of operations within SEZ and all facilities of import and export are provided within the zone itself.

SEZ units may be set up for manufacture of goods and rendering services. Trading units are also permitted.

Exemption from all taxes - SEZ and SEZ units will be exempt from all taxes like customs duty, excise duty, Central sales tax, State Vat, Income tax etc.

Types of SEZ - Multi-product SEZs should have an area of 1,000 hectares or more. Minimum 35% area shall be earmarked for processing. Remaining 65%/75% area will be available for developing residential and commercial areas. Sector specific SEZ can be as small as 10 hectares, out of which 50% should be for processing and balance can be for residential and commercial areas. SEZ for Free Trade and Warehousing (FTW) shall have an area of 40 hectares or more with a built up area of not less than one lakh square meters.

Integrated township plus manufacturing facilities - SEZ can be set up in public, private, joint sector or by Central Government or State Government, jointly or severally SEZ will be developed by Developers.. The Developer can allocate fully developed plots to entrepreneurs on purely commercial basis.

Developer of SEZ can provide services like water, electricity, security, restaurants, recreation etc. He can also develop township adjacent to SEZ. Proposal to establish a SEZ will be approved by Board of Approvals (BOA).

Trading in SEZ - Trading in imported goods as well as indigenous goods is permitted. However, benefit of section 10AA of Income Tax will not be applicable to such trading, other than trading in nature of re-export of imported goods – MC&I (DC) Instruction No. 4/2006 F No. 5/1/2006-EPZ) dated 24-5-2006 [210 ELT E12]. In case of trading, income tax benefits are available only in case of re-exports [see *explanation* to rule 76].

10.4.1 Special Economic Zones Act and Rules

Special Economic Zones Act, 2005 was passed by Parliament in May 2005. Basic purpose of the Act is smooth and hassle free operations in SEZ and a 'Single Window Clearance' for setting up an SEZ or a unit in SEZ. Major provisions of the Act have been made effective w.e.f. 10-2-2006. Sections 20 to 24 (dealing with offences in SEZ and civil suits arising in SEZ) and sections 31 to 41 (Establishment of SEZ Authority) have not been brought into force.

SEZ Act and Rules provide complete policy towards SEZ

The SEZ Act provides for the following -

- **Establishment of SEZ with approval from Board of Approvals (section 3 of SEZ Act).**
- **Notifying an area as SEZ by Central Government (sections 4 and 5 of SEZ Act).**
- **Board of Approval to approve establishment of SEZ (Sections 8 to 10 of SEZ Act).**

- **Development Commissioner for one or more SEZ as administrative authority for the SEZ (sections 11 and 12 of SEZ Act).**
- **Approval Committee to approve setting up an unit in SEZ (sections 13 and 14 of SEZ Act).**
- **Single window clearance by Approval committee for setting up unit in SEZ, OBU (Offshore Banking Unit) or International Finances Service Centre (sections 15 to 20 of SEZ Act).**
- **Appeal against decision of Approval Committee to Board of Approval [section 16(4) of SEZ Act and rules 55 to 69 of SEZ Rules]**
- **Enforcement Agency or Enforcement Officer in respect of notified offences committed in SEZ (sections 21 and 22 of SEZ Act - Not brought into effect).**
- **Special Civil Courts for SEZ and criminal courts to try notified offences in SEZ and appeal to High Court [sections 23 and 24- Not brought into force].**
- **Reliefs from Income Tax, customs duty, service tax, central sales tax and excise duty and duty drawback on goods brought or services provided from DTA to SEZ developer or SEZ Unit (sections 26 to 29 of SEZ Act).**
- **Exemption from taxes as specified in First Schedule to SEZ Act (sections 7 and 26 of SEZ Act).**
- **Customs duty on goods supplied from SEZ unit to DTA (section 30 of SEZ Act).**
- **Establishment of SEZ Authority (sections 31 to 41 - these sections have not been brought into force).**
- **Compulsory reference of dispute to arbitration (sections 42 and 43 of SEZ Act).**
- **Exemptions and relaxations from provisions of certain Central Acts (sections 49 and 54 of SEZ Act).**

10.4.2 Highlights of SEZ Rules

SEZ Rules, 2006 provide for the following -

- **Procedure for establishment of SEZ (Rules 3 to 16).**
- **Procedure for establishment of a Unit in SEZ (Rules 17 to 21).**
- **Terms and conditions for entitlement of exemptions, drawbacks and concessions (Rules 22 to 46 - Chapter IV).**
- **Conditions for removal of goods from SEZ to DTA (Chapter V - Rules 47 to 50).**

- **Requirements and monitoring of Foreign Exchange Earnings (Chapter VI - Rules 53 to 54).**
- **Procedures for appeal to Board of Approval from order of Approval Committee (Chapter VII - Rules 55 to 69).**
- **Provisions relating to Identity Card, foreign exchange remittances, revival of sick unit, exit of unit and self declaration.**
- **Prescribed Forms A to K**

SEZ Rules provide for-

- **Simplification of procedures for development, operation, and maintenance of the Special Economic Zones and for setting up and conducting business in SEZs.**
- **Single window clearance for setting up of an SEZ.**
- **Single window clearance for setting up a unit in a Special Economic Zone.**
- **Single Window clearance on matters relating to Central as well as State Governments.**
- **Simplified compliance procedures and documentation with an emphasis on self certification; and**
- **A wide range of services can be rendered from SEZs.**
- **Documentation for various activities of the units has been reduced to the barest minimum with an emphasis on self-certification.**
- **No requirement for providing bank guarantees, thereby reducing transaction costs.**
- **Contract manufacturing for foreign principals allowed.**
- **Option to obtain sub-contracting permission at the initial approval stage.**
- **Import - Export of all items, through personal baggage has been allowed.**

10.4.3 Policy to set up SEZ

Central Government has liberal policy for setting up such zones. SEZ can be set up in public, private, joint sector or by Central Government or State Government, jointly or severally [section 3(1) of Act]. Developer of such SEZ can allocate fully developed plots to entrepreneurs on purely commercial basis. Developer of SEZ can provide services like water, electricity, security, restaurants, recreation etc. He can also develop township adjacent to SEZ.

Proposal to establish a SEZ will be approved by Board of Approvals (BOA). Procedure to be followed for establishment of SEZ is given in Rules 3 to 16 of SEZ Rules, 2006.

10.4.4 Conditions relating to area and its utilisation

SEZ should have minimum specified area. In respect of non-processing areas, developer cannot lease vacant lands.

Area requirements of SEZ **- Minimum area of land and other terms and conditions of approval shall be prescribed by Central Government [section 3(8) of SEZ Act]. Minimum area requirements stipulated for various categories of SEZs are as follows.**

As per press report dated 5-4-2007, maximum area of SEZ can be 5,000 hectares. Minimum processing area shall be 50%. State Government shall not undertake any compulsory acquisition of land for such SEZ. Comprehensive resettlement and rehabilitation policy will be worked out ensuring livelihood of displaced persons.

Multi-product SEZ - Multi-product SEZs should have an area of 1,000 hectares or more [rule 5(2)(a) of SEZ Rules]. "Special Economic Zone for multi-product" means a Special Economic Zone where Units may be set up for manufacture of two or more goods in a sector or goods falling in two or more sectors or for trading and warehousing or rendering of two or more services in a sector or rendering of services falling in two or more sectors [rule 2(za) of SEZ Rules]

Minimum 35% area shall be earmarked for processing. This can be relaxed to 25% by Central Government on recommendation from Board of Approvals. Thus, remaining 65%/75% area will be available for developing residential and commercial areas.

Service Sector SEZ - Services-Sector SEZs should have an area of 100 hectares or more [first proviso to rule 5(2)(a) of SEZ Rules].

Minimum 35% area shall be earmarked for processing. This can be relaxed to 25% by Central Government on recommendation from Board of Approvals. Thus, remaining 65%/75% area will be available for developing residential and commercial areas.

SEZ in port or airport - In case of SEZ in port or airport, the area must be at least 100 hectares [rule 5(2)(b) of SEZ Rules]. "Special Economic Zone in a port or airport" means a Special Economic Zone in an existing port or airport for manufacture of goods in two or more goods in a sector or goods falling in two or more sectors or for trading and warehousing or rendering of services [rule 2(zc) of SEZ Rules].

Sector Specific SEZ **-** In some sectors where India has a competitive advantage, such as gems and jewellery, information technology, electronic hardware and software, bio-technology, sector-Specific SEZs can be set up over an area of 10 hectares or more Similarly, in case of SEZ in non-conventional energy, solar energy, the area shall be 10 hectares or more [first and second proviso to rule 5(2)(b) of SEZ Rules]

In case of SEZ for specific sectors, at least 50% of the area shall be earmarked for developing processing area. Thus, remaining 50% area will be available for developing residential and commercial areas.

10.5 ADVANCE AUTHORISATION

Inputs required to manufacture export products can be imported without payment of customs duty under Advance Authorisation. Advance Authorisation can be granted to merchant exporter or manufacturer exporter to import raw materials. Since the raw materials can be imported before exports of final products, the authorisation issued for this purpose is called '**advance Authorisation**'. [This was termed as 'Advance License' upto 1-4-2006]. Paras 4.1.3 to 4.1.14 of FTP and paras 4.4 to 4.30 of HOP (Vol. 1) make provisions in respect of 'advance authorisation'.

Advance authorisation is issued to allow duty free import of inputs with normal allowance for wastage. In addition, fuel, oil, energy, catalysts etc. required can also be allowed. Duty free import of mandatory spares upto 10% of CIF Value of Authorisation, which are required to be exported with resultant products may also be allowed. However, prohibited items of imports cannot be imported [paras 4.1.3 of FTP].

Advance authorisation will indicate name and description and of items to be imported and exported / supplied, aggregate CIF value of imports, FOB / FOR value and quantity of exports / supplies. If quantity cannot be indicated, value shall be indicated. Goods can be exported in anticipation of advance authorisation, after submission of application to licensing authority.

The advance authorisation will be for Actual User only. It is not transferable. The material imported under advance authorisation is also not transferable even after completion of export obligation. However, goods manufactured out of such imported material can be disposed of, after export obligation is fulfilled [para 4.1.5 of FTP].

There must be positive value addition [para 4.1.6].

Export Obligation - Export should be within 24 months from date of issuance of authorisation. In case of projects, export obligation shall be fulfilled within duration of execution of project. In case of Advance Authorisation for drugs issued against specific order, export obligation shall be fulfilled within 6 months from date of import of first consignment (para 4.22 of HOP Vol. I).

Advance authorisation can be revalidated for 6 months if export obligation was fulfilled, on payment of composition fee of 2% of duty saved on all unutilised imported items, by submitting application in 'Aayat Niryat Form'. Further extension of 6 months can be obtained on payment of 5% of duty saved on all unutilised imported items as composition fee (para 4.22.1 of HOP Vol. 1).

There is no extension beyond 36 months (24+12 months) – MF(DR) circular N. 16 / 2006-Cus dated 9-5-2006.

If it is not possible to fulfil export obligation in time, extension has to be obtained from licensing authority (i.e. DGFT). If there is marginal shortfall upto 5%, it can be regularised. If shortfall is higher (upto 50%), extension upto one year can be obtained on submission of bank guarantee of full amount of duty saved. Shortfall in exports can be regularised on payment of duty along with interest @ 15%.

Application for advance authorisation - Application for authorisation shall be made in duplicate in '*Aayat Niryat Form*' given in Handbook of Procedures (HOP) [para 4.4 of HOP (Vol. 1).

SION - The imports of raw materials is on the basis of standard input–output norms (SION). The SION are finalised and quantity allowed to be imported will be based on quantity exported. The price of inputs will be as declared by applicant. However, there must be positive value addition.

SION is fixed by 'Norms Committee'. Advance authorisation can be issued on basis of self declaration, subject to final adjustment as per SION fixed by NC (Norms Committee). (para 4.7 of HOP Vol. 1).

Exports in anticipation of authorisation – Exports in anticipation of Advance Authorisation is permissible, if procedure as specified in para 4.12 of HOP (Vol. 1) is followed. Advance authorisation after exports can be issued on basis of actual proof of exports. In such case, BG / LUT [Bank Guarantee / Letter of Undertaking] is not necessary (para 4.18(a) of HOP Vol. 1). In *CC* v. *Hindustan Tobacco* 2006 (193) ELT 190 (CESTAT), it was confirmed that export can be made in anticipation of license (now authorisation w.e.f. 1-4-2006).

EOU/SEZ/EHTP/BTP/STP can supply goods against advance authorisation – EOU / SEZ / EHTP / DTP / STP units can supply goods against advance authorisation. It is not necessary to convert advance authorisation into advance release order. The supplier will be entitled to benefits of deemed exports [amendment dated 17-5-2005 to FTP.].

Advance release order - Goods can be procured from indigenous manufacturer against advance release order (ARO) to be issued by RA (Regional Authority) (earlier known as Regional Licensing Authority upto 31-3-2006). The ARO can be denominated in foreign exchange / Indian Rupees [para 4.1.11 of FTP]. Alternatively, exporter can obtain goods from indigenous sources on basis of back to back Inland Letter of Credit (LC) from bank [para 4.1.12 of FTP and para 4.15 of HOP (Vol. 1)]. The value of Advance Authorisation will be reduced to that extent. - - Goods can be obtained from EOU / EHTP / SEZ / STP / BTP unit on basis of Advance Authorisation or DFRC. It is not necessary to convert Advance Authorisation into ARO (Advance Release Order) [para 4.1.11 of FTP].

Advance authorisation for intermediate supplies - In respect of supplies made against advance authorisation / DFRC / DFIA against 'deemed export', the supplier is entitled to Advance Authorisation / DFRC / DFIA for intermediate supplies – para 8.4.1(i) of FTP.

Import and Export from specified port – Export and import under advance authorisation can be through sea ports, airports, ICDs and LCS specified in para 4.19 of HOP Volume I. Export shipments can be effected from any of SEZs.

Advance authorisation for annual requirements to exporters – Annual Advance authorisation would be issued to exporters having past export performance to enable them to import their requirements of inputs on annual basis. Annual Advance Authorisation will be granted upto 300% of FOB value of exports in preceding financial year. There should be positive value addition [para 4.1.10 of FTP]. Customs Notification No. 94 / 2004-Cus dated 10-9-2004 make provisions for such annual authorisation.

10.6 DUTY ENTITLEMENT PASS BOOK SCHEME (DEPB SCHEME)

The scheme is easy to administer and more transparent. The scheme is similar to Cenvat credit scheme. The exporter gets credit when he exports the goods. The credit is on basis of rates prescribed. This credit can be utilised for payment of customs duty on imported goods.

As per para 4.3 of FTP, DEPB scheme will continue to be in operation until it is replaced by a new scheme, which will be drawn up in consultation with exporters. DEPB scheme has been extended upto 31-3-2008 by customs notification No. 48/2007-Cus dated 29-3-2007. Same provision in amendment to Foreign Trade Policy, announced on 18-4-2007.

The scheme is proposed to be replaced by a new scheme, since it is said that existing scheme is not WTO compliant.

The objective of the scheme is to neutralise incidence of customs duty on the import content of export product. The neutralisation shall be provided by way of grant of duty credit against the export product [para 4.3 of FTP].

Exporter can have either DEPB or duty drawback and not both.

Exports under DEPB scheme are allowed only when DEPB rate for the concerned export product is finalised.

Under this scheme, exporters will be granted duty credit on the basis of notified entitlement rates. The entitlement rates will be notified by DGFT. The entitlement rates will be a percentage of FOB made in free foreign currency. The entitlement rate will be fixed on basis of SION (Standard Input Output Norms) and deemed import content. Value addition achieved in export product will also be taken into account [para 4.3.1 of FTP].

DEPB is a post export duty remission scheme, which allows neutralization of deemed import duty charges on inputs used in the export product as per SION and the basic customs duty payable on such deemed imports. Value addition is also taken into account – para 4.37 of HOP (Vol. 1).

Credit can be utilised for payment of customs duty on *any item* which is freely importable [para 4.3.1 of FTP and para 4.42 of HOP Vol. 1]. [Till 1-4-2006, the credit could not be used for payment of customs duty on capital goods].

Credit can be used for payment of basic customs duty as well as CVD. The importer has option to pay CVD by cash [para 4.3.2 of FTP].

The credit can also be used for payment of special CVD of 4%. If the CVD is paid by debit to DEPB, Cenvat credit/brand rate of duty drawback is available - MF(DR) circular No. 18/2006-Cus dated 5-6-2006.

The credit can be transferred to another person, but the transfer will be valid for imports within the same port from where exports were made. Import from other port will be available under TRA facility [para 4.3.4 of FTP].

DEPB is valid for 24 months for import [para 2.12 of HOP Vol. 1]. The DEPB and / or the items imported are freely transferable. However, DEPB can be transferred only after realisation of export proceeds.

The scheme is available to both manufacturer exporters as well as merchant exporters. DEPB has to be registered with customs house.

Application for DEPB - Filing of applications for DEPB and Advance Authorisation through DGFT website is compulsory w.e.f. 16-1-2006. The application should be digitally signed and fees shall be paid electronically. The procedure is prescribed in DGFT policy circular No. 44 (RE-2005) / 2004-09 dated 10-1-2006.

Actual import content in export product not required – DEPB credit to be granted is not related to actual content of imported goods in export products, but deemed import content – *Anjani International* v. *CC* 2005 (186) ELT 512 (CESTAT).

No All India rate of duty drawback if goods exported under DEPB – If goods are exported under DEPB, All Industry Rate of duty drawback will not be available - para 2(g) of customs Notification No. 8 / 2005-Cus(NT) dated 18-1-2005.

Duty drawback and CVD credit available even if duty paid through DEPB, w.e.f. 17-9-2004 – Earlier, it was clarified that Cenvat of CVD can be availed only if CVD is paid in cash. Similarly, duty drawback was allowed only if CVD was paid in cash. However, para (vi) of notification No. 96 / 2004-Cus dated 17-9-2004 now specifically provides that drawback or Cenvat credit of CVD can be availed against amount debited in DEPB. The benefit is available only in respect of DEPB issued under Foreign Trade Policy i.e. on or after 1-9-2004 – confirmed in MF(DR) circular No. 59 / 2004-Cus dated 21-10-2004.

Para 4.3.5 of Foreign Trade Policy (FTP) reads as follows – 'Normally, the exports made under the DEPB scheme shall not be entitled for drawback. However, the additional customs duty / excise duty paid in cash or through debit under DEPB shall be adjusted as Cenvat credit or duty drawback as per rules framed by Department of Revenue'. Thus, Cenvat credit is available whether CVD is paid in cash or by debit to DEPB.

Duty drawback of CVD is available even when CVD is paid through DEPB credit – MF(DR) circular No. 41 / 2005-Cus dated 28-10-2005.

Customs can check PMV – In *Om Prakash Bhatia* v. *CC* 2003 AIR SCW 3452 = 155 ELT 423 (SC), it was held that over invoicing is an offence. To such goods, section 113(d) would apply and they can be confiscated. - - If margin of profit appears unreasonable, it is for the exporter to establish that it was a true export value stated in the shipping bill. [view held in *Om Prakash Bhatia* v. *CC* 2001(127) ELT 81 (CEGAT 5 member bench) confirmed].

Who cannot avail DEPB ? – Following cannot avail DEPB – (a) Goods manufactured in customs bonded warehouse (b) Goods exported against discharge of export obligation under Advance Authorisation (c) EOU, SEZ, STP, BTP or EHTP units (d) Export of goods of foreign origin, unless there is manufacture or processing (e) Exports made under specified paras of FTP.

Sales tax on sale of DEPB – DEPB (Duty Entitlement Passbook Scheme) is freely tradable. It is right to claim back credit. It is freely tradable and is 'goods'. It is taxable under sales tax. It is not actionable claim. – *Philco Exports* v. *STO* (2001) 124 STC 503 (Del HC DB). However, Haryana Tax Tribunal in case of *Sadhu Overseas*, has held that DEPB is a sort of money which can be used either by dealer or anybody else. Hence it is not 'goods' [CS September 2004 – page 1333].

10.7 DUTY FREE IMPORT AUTHORISATION (DFIA)

'Duty Free Import Authorisation' (DFIA) has been introduced w.e.f. 1-5-2006 as per para 4.4 of Foreign Trade Policy. Corresponding customs notification No. 40/2006-Cus dated 1-5-2006 has been issued. The scheme is said to contain features of Advance Authorisation and DFRC scheme.

'Advance Authorisation' is not transferable, while material imported under DFIA will be transferable after fulfillment of export obligation. In case of Advance Authorisation, positive value addition is sufficient, while in case of DFIA, 20% value addition is required, except in case of gem and jewellery sector.

DFIA is issued to allow duty free import of inputs used in manufacture of export product (with normal allowances for wastages), and fuel, energy, catalyst etc. Duty free import of mandatory spares upto 10% value of authorisation, which are required to be exported/supplied with resultant product is also allowed.

DFIA is issued on basis of SION. Import Authorisation will be limited to quantity mentioned in SION. DFIA is issued to manufacturer-exporter or merchant-exporter for following – (i) Physical exports including supplies to SEZ (b) Intermediate supplies and (c) Main contractors for supply of goods under Deemed Exports (except supply against Advance Authorisation and marine containers). In case of some deemed exports, DFIA is available to sub-contractors also [para 4.4.2 of FTP].

DFIA is initially issued with 'actual user condition'. Imports will be exempted from payment of basic customs duty, additional customs duty, education cess, anti-dumping duty and safeguard duty, if any [para 4.4.2 of FTP]. After export obligation is fulfilled, the scrip can be made transferable by Regional Authority. After endorsement of transferability, duty free inputs (except fuel) can be transferred. However, where SION is subject to 'actual user' norm, transferability is not allowed. In case of fuel, import entitlement can be transferred only to companies which have been granted authorisation to market fuel by Ministry of Petroleum and Natural Gas [para 4.4.6].

Cenvat credit will not be available in respect of inputs [para 4.4.7]. Drawback will be available only in respect of duty paid material used in goods exported as per drawback rate fixed by Ministry of Finance [para 4.4.8 of FTP].

Duty free procurement from domestic market is permissible against ARO/invalidation letter/back to back inland LC [para 4.4.3 of FTP]

Value addition should be minimum 20%, except in case of gem and jewellery sector and items

for which higher value addition has been prescribed under Advance Authorisation Scheme [para 4.4.4 of FTP].

In respect of supplies made against advance authorisation / DFRC / DFIA against 'deemed export', the supplier is entitled to Advance Authorisation / DFRC / DFIA for intermediate supplies – para 8.4.1(i) of FTP.

In respect of sensitive items mentioned in para 4.55.3 of Handbook, exporter will have to furnish declaration with regard to technical characteristics, quality and specification in shipping bill – MF(DR) circular No. 16 / 2006-Cus dated 9-5-2006.

Customs procedures as prescribed in customs notification No. 40 / 2006-Cus dated 1-5-2006.

10.8 EPCG AUTHORISATION

Under Export Promotion Capital Goods (EPCG) scheme, an authorisation holder can import capital goods (i.e. plant, machinery, equipment, components and spare parts of the machinery) at concessional rate of customs duty of 5%. Capital goods can be imported for pre-production, production and post production (including CKD / SKD of capital goods and computer software systems) – para 5.1 of FTP.

Capital goods which can be imported under 'project imports' can be imported under EPCG scheme. The export obligation will be 8 times the duty saved i.e. difference between concessional rate under project imports and rate applicable under EPCG – para 5.1B of FTP.

Capital goods required for retailers having minimum area of 1,000n SqM is permissible – para 5.1C of FTP.

Importer will be issued 'EPCG Authorisation' for this purpose.

Conditions for EPCG are contained in chapter 5 of FTP.

Importer can either claim exemption of CVD or pay CVD in cash. If he pays CVD in cash, that amount will not be considered for purpose of fixation of export obligation. However, in that case, he cannot avail Cenvat credit of the CVD paid (Amendment w.e.f. 2-3-2005. Till now, importer could pay CVD in cash and avail Cenvat credit. Now, if he pays CVD in cash, his export obligation will get correspondingly reduced, but he cannot avail Cenvat of CVD paid in cash).

Computer software systems are also eligible. Import of spares of capital goods is permitted, without any limit. Jigs, fixtures, dies, moulds will be allowed to the extent of 100% of CIF value of authorisation. Spares for existing plant and machinery can also be imported. Second hand capital goods can also be imported under EPCG scheme

However, second hand capital goods of Indian origin are not permitted under EPCG scheme – DGFT Policy circular No. 16 (RE-2005) / 2004-09 dated 15-7-2005.

Hotel equipment (window cleaning equipment in this case) can be imported under EPCG scheme – *CC* v. *Hotel Leela Venture Ltd.* 2003 (158) ELT 777 (CESTAT).

Authorisation will be issued on the basis of certificate of Chartered Engineer in respect of imported capital goods and exported final product.

Merchant Exporters can also import capital goods under EPCG scheme, if the capital goods are installed in the factory of their supporting manufacturer. The name and address of supporting manufacturer should be endorsed on EPCG authorisation and bond with Bank guarantee has to be executed jointly and severally by merchant exporter and his supporting manufacturer.

The import is permitted only through specified port of registration. If EPCG is registered at one place but import is from other customs house, the import shall be permitted against TRA (Telegraphic Release Order) which will be issued by customs house at port of registration – MF(DR) circular No. 88/2003-Cus dated 6-10-2003.

Clubbing of EPCG authorisations - All EPCG authorisations issued under one notification in one financial year and for export of same product/s or services will be clubbed for reducing paper work and easy monitoring – para 5.18 of HOP.

Export obligation - Importer has to fulfil export obligation equal to eight times duty saved on imported capital goods to be fulfilled over a period of 8 years. In respect of capital goods imported for technological upgradation, export obligation will be six times the duty saved. 50% export obligation should be fulfilled in first block of 6 years and balance 50% in next block of two years. SSI units will have export obligation equal to 6 times duty saved on capital goods imported, to be fulfilled over a period of 8 years. Agro units will have export obligation of 6 times the duty saved, to be fulfilled over period of 12 years [para 5.1 of FTP]

Extension of export obligation beyond 8+2 years can be considered for a further period of two years with condition that 50% of duty payable in proportion to unfulfilled export obligation is paid to customs – para 5.11 of HOP - – MF(DR) circular No. 16/2006-Cus dated 9-5-2006.

In respect of EPCG authorisation for Rs 100 crore or more, the export obligation shall be required to be fulfilled over a period of 12 years. Similarly, sick companies under BIFR and units in Agri Export Zones can fulfil export obligation in 12 years. Export obligation for every block has been specified. Extension for fulfilling export obligation upto two years can be obtained. – MF(DR) circular No. 25/2003-Cus dated 1-4-2003 [para 5.1 of FTP].

If 75% export obligation is completed in half or less than half the prescribed period, companies can be freed from their obligations in remaining period (para 5.11 of FTP).

The export obligation shall be fulfilled by export of goods capable of being manufactured or produced by the capital goods imported under the scheme. However, goods can be manufactured in other unit of authorisation holder also. The export obligation will be over and above the average level of exports achieved during preceding three licensing years. - - Export obligation can also be fulfilled by export of other goods manufactured by the importer. Exports of goods/services by group companies will also be considered towards fulfilment of export obligation. However, in such case, additional export obligation will be over and above the average exports achieved by unit/group company/managed hotel in preceding three years – para 5.4(i) of FTP.

Exports shall be physical exports, but some deemed exports are eligible. Royalty payments and payments for R&D services received in free foreign exchange will be considered towards fulfilment of export obligation – para 5.4(iv) of FTP.

EPCG authorisations can be clubbed for discharge of export obligation.

STUDY NOTE - 11

CENTRAL SALES TAX

This Study Note includes

- Introduction
- Inter State Sale
- Goods under Sales Tax Act
- Sale under Sales Tax Act
- Dealer under Sales Tax Act
- Quantum of CST Payable
- Goods of Special Importance
- Appeals and Penalty under CST Act
- Prescribed Forms under CST Act

11.1. INTRODUCTION

- Sale tax on Inter State sale is levied by Union Government, while sales tax on intra-State sale (sale within State) is levied by State Government.

- Sale can be either Inter-State, sale in the course of import / export or intra-State.

- CST is payable on inter-State sales, while Vat (State sales tax) is payable on sale within the State. No sales tax is payable on sale in the course of import / export.

- Even if CST is levied by Union Government, the revenue goes to State Government. CST Act is administered by State Government.

Categories of Sales **-** Sales can be broadly classified in three categories. (*a*) Inter-State Sale (*b*) Sale during import / export (*c*) Intra-State (i.e. within the State) sale. - *Murli Manohar & Co.* v. *State of Haryana* (1991) 80 STC 79 = (1991) 1 SCC 377 (SC 3 member bench). In this case, it was observed that they cannot conceive fourth category of sale.

'Sale within State' is residuary sale. Thus, first we have to decide if sale is 'Inter State'. If not, we have to find if it is 'Sale during export or import'. If not, then the sale is 'Intra State'. If a sale is Inter State or during export or import, it cannot be 'Sale within the State'.

11.1.1 Constitutional Background

Constitutional background relating to sales tax is as follows -

- Entry 92A of List I (Union List) empowers Central Government to impose tax on inter-state sales. The entry reads 'Taxes on the sale and purchase of goods other than newspapers, where such sale or purchase takes place in the course of Inter-State trade or commerce'.

- Entry 54 of list II - State List - reads : 'Tax on sale or purchase of goods other than newspapers except tax on Inter State sale or purchase'.
- Trade, commerce and intercourse throughout the territory of India shall be free, subject to provisions of Articles 302 to 304 of Constitution. [Article 301]
- State can impose tax on goods imported from other States or Union Territories, but a State cannot discriminate between goods manufactured in the State and goods brought from other States [Article 304(1)].
- State Government cannot impose tax on sale or purchase during imports or exports; or tax on sale outside the State. [Article 286(1)]
- Article 269(3) and Article 286(2) of Constitution authorises Parliament to formulate principles for determining when the sale or purchase takes place outside a State or in the course of imports and exports.
- Article 286(3) of Constitution authorises Parliament to place restrictions on tax on 'declared goods'.

CST Act imposes the tax on inter state sales and states the principles and restrictions as per the powers conferred by Constitution.

CST collected in the State where movement of goods commences - The scheme of CST Act is that Central Sales Tax is payable in the State from which movement of goods commences (i.e. from which goods are sold). The tax collected is retained by the State in which it is collected. CST Act is administered by Sales Tax authorities of each State. Thus, the State Government Sales Tax officer who collects and assesses local (State) sales tax also collects and assesses Central Sales Tax.

11.2 INTER STATE SALE

- Inter State can be either direct u/s 3(a) or by transfer of documents u/s 3(b) of Central Sales Tax Act.
- In case of inter state sale u/s 3(a), sale is inter state if it occasions movement of goods from one State.
- Sale is inter state even if goods move from one State to another under 'agreement to sale'. The agreement may be express or even implied.
- Property in goods can pass to buyer in either State.
- Location of buyers is not relevant. If sale occasions movement of goods from one State to another, it is inter state even if both buyer and seller are in same State.

11.2.1 Inter State Sale by transfer of documents

- Inter Stale sale can be by transfer of documents of title during movement of goods from one State to another. The 'document' can be LR, RR or AWB.
- The movement of goods commences as soon as goods are handed over to transporter. The 'movement' is deemed to be continuing till delivery of goods is taken at other end.
- Transfer of Document is a symbolic delivery of goods to the purchaser. It carries with it full ownership of goods. Delivery of 'document of title' is equivalent to the delivery of goods themselves.
- E-I/E-II transactions are required to establish sale during movement. If done, all subsequent sales are exempt from sales tax/Vat.

11.2.2 Stock Transfer/Branch Transfer

- In stock/branch transfer, goods move from one State to another, but there is no 'sale'.
- Stock transfer can be only of standard goods. Stock transfer of tailor made goods for a specific customer is a bogus stock transfer.
- If buyer is identifiable before goods are dispatched, it is 'Inter State' sale and not a 'stock transfer'.
- Form F is required to be submitted to establish stock transfer.
- It is possible that a dealer may treat a transfer as 'stock transfer' while STO may tax it as 'sale'. In such case, the same transaction will be taxed by two States. If there is double taxation, CST Appellate Authority can grant relief.

11.2.3 Sale inside the State

- If a sale is inside one State, it is outside all other States.
- In case of specific or ascertained goods, sale within State takes place at the time of contract.
- In case of unascertained or future goods, sale takes place when goods are appropriated to contract in the State.
- If sale is inter-state as defined in section 3 of CST Act, it can never be 'intra state' sale.
- Sale within territorial waters of India i.e. within 12 nautical miles from the base line on the coast of India the is 'local sale'.

11.3 GOODS UNDER SALES TAX ACT

- Goods include all kinds of movable property, but not newspapers, actionable claims, stocks, shares and securities.
- Intangible or incorporal articles are 'goods' e.g. patent, copyright.
- Software (branded as well as unbranded) is goods - *Tata Consultancy Services* v. *State of Andhra Pradesh* (2004) 141 Taxman 132 = AIR 2005 SC 371 = 2004 AIR SCW 6583 = 271 ITR 401 = (2005) 1 SCC 308 = 137 STC 620 = 178 ELT 22 (SC 5 member bench) * *Bharat Sanchar Nigam Ltd.* v. *UOI* (2006) 3 SCC 1 = 152 Taxman 135 = 3 STT 245 = 145 STC 91 = 282 ITR 273 = AIR 2006 SC 1383 = 2 STR 161 (SC 3 member bench).
- Lottery ticket is 'actionable claim' and not taxable - *Sunrise Associates* v. *Government of NCT of Delhi* (2006) 4 STT 105 = 145 STC 576 (SC 5 member Constitution Bench) [This decision applies prospectively w.e.f. 28-4-2006 and not retrospectively, as per specific order of SC].
- In view of the above, earlier judgments about DEPB/Advance Authorisation have come into doubt.
- Simple sale of SIM card can be taxed, but not when supplied as incidental to service - *Bharat Sanchar Nigam Ltd.* v. *UOI* (2006) 3 SCC 1 = 152 Taxman 135 = 3 STT 245 = 145 STC 91 = 282 ITR 273 = AIR 2006 SC 1383 = 2 STR 161 (SC 3 member bench).

11.4 'SALE' UNDER SALES TAX ACT

- Sale can be actual (conventional) sale or deemed sale.
- Conventional sale takes place when there is complete transfer of property in goods from buyer to seller for money consideration.
- Charge, mortgage, hypothecation, pledge, simple job work, branch transfer and barter is not sale.
- Supply to Agent is not 'sale'.

Deemed sales under CST Act – 'Deemed sale' is treated as 'sale' for sales tax purposes, though it does not have all ingredients of 'sale'

- Concept of deemed sale has been introduced by 46th amendment to Constitution, by inserting Article 366(29A) in 1983.
- Compulsory sale, hire purchase, leasing, hire (transfer of right to use), sale of food articles, sale by unincorporated association and goods involved in works contract are 'deemed sales'.

- In case of works contract, sales tax / vat can be levied only on value of goods involved and not on entire value of contract.
- Composition scheme to levy tax on flat basis on entire value of contract is permissible.

11.4.1 What is works contract

Section 2(ja) of CST Act defines 'works contract' as follows – 'Works contract' means a contract for carrying out any work which includes assembling, construction, building, altering, manufacturing, processing, fabricating, erection, installation, fitting out, improvement, repair or commissioning of any movable or immovable property.

Definition of 'works contract' in section 2(zt) of Haryana VAT Act is identical. Definitions in section 2(zo) of Delhi VAT Act, section 2(52) of Tamilnadu VAT Act, section 2(45) of AP Vat Act and section 2(zu) of Punjab VAT Act. Definition in section 2(57) of West Bengal VAT Act is elaborate, but more or less similar.

Explanation (b)(ii) to section 2(24) of Maharashtra Vat Act states that works contract *includes* an agreement for carrying out for cash, deferred payment or other valuable consideration, the building, construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any movable or immovable property.

Definition in section 2(37) of Karnataka VAT Act is also similar.

Any contract for carrying out work is covered.

Tax is on goods involved in works contract and not on works contract as such - Note that the CST is on 'goods involved in works contract' and ***not on*** 'works contract' as such. In *Studio Kamalaya* v. *CTO* 1993(89) STC 307 (WBTT), it was observed, 'All works contract are not taxable. Transaction is taxable only when there is transfer of property in goods involved.

Basic distinction between sale of goods and works contract - Distinction between sale of goods and works contract is as follows –

Sale	Works Contract
It is 'sale'	It is 'deemed sale'.
Relation is seller and buyer	Relationship is contractor and contractee
In sale of goods, the thing produced / manufactured as a whole is absolute property of maker when it comes into existence. He then transfers it to buyer.	In works contract, the things produced as a whole is never absolute property of maker, even though material used in works contract might have been his absolute property.
In sale, the sale is '*chattel qua chattel*', i.e. 'goods' are sold as 'goods'. The property in goods is transferred at the time of delivery of finished article	The article produced as a whole directly becomes property of buyer, without first becoming property of maker. Property in goods contained in works contract passes by accretion, accession or blending during the execution of work.
Contract is primarily for supply of materials at prices agreed and the work or service is incidental to the execution of contract	Contract is primarily a contract of work and labour and materials are supplied in execution of such contract.
Rejection of goods is possible.	Rejection of goods is generally difficult.
Sale is taxable under sales tax laws.	Transfer of property in goods involved in works contract is 'deemed sale' and taxable under sales tax laws.
Sale can be of standard goods as well as tailor made goods.	Works contract is only tailor made i.e. for a specific contractee.
Buyer usually never supplies any material to seller.	Contractee often supplies material to contractor.
Sale of Goods Act applies to the transaction.	Indian Contract Act applies to transaction.
TDS provisions are not applicable (though there is no constitutional bar in applying TDS provision to sale of goods)	TDS provisions are applicable to works contract – both under Income Tax Act and many State Vat Acts.

11.5 DEALER UNDER SALES TAX ACT

Definition of 'dealer' and 'business' vary from State to State. However, broadly, following principles apply, unless the definition of Vat Act of a State has made specific different provision in the definition.

- Definition of 'dealer' is wide, but only those who 'effect' sale are liable to register and pay CST.
- Ancillary, incidental and casual business is also taxable, but main activity should be 'carry on business'.
- Government and railways are 'dealers'.
- In *State of Tamilnadu* v. *Board of Trustees* 1999 AIR SCW 1262 = AIR 1999 SC 1647 = (1999) 4 SCC 630 = 114 STC 520 [confirming *Board of Trustees of Port of Madras* v. *State of Tamilnadu* (1998) 108 STC 66 = (1997) 10 MTCR 373 (Mad HC DB)], it was held that Government is dealer only if it is 'carrying on business of buying, selling, supplying or distribution of goods'.
- Insurance company is also 'dealer'.
- Bank can be dealer in respect of sale of pledged goods, if definition of 'dealer' includes bank. Sale of pledged goods takes place in the course of business – *Federal Bank Ltd.* v. *State of Kerala* (2007) 6 VST 736 (SC)
- In *Karnataka Pawn Brokers Assn.* v. *State of Karnataka* AIR 1999 SC 201 = 111 STC 752 = 1999 AIR SCW 3564, it was held that an auctioneer is not a dealer, if he does not transfer the property in the goods to the highest bidder.
- Profit motive is not material for 'Business'. Adventure is also 'business'.
- Incidental business can be taxed. However, sale of business is not 'business' and cannot be taxed under sales tax provisions.

11.6 QUANTUM OF CST PAYABLE

Following are broad principles. Generally, these apply to State Vat also, unless the definition of State law is different.

- CST rate for sale to registered dealers is 3% or local sales tax rate, whichever is lower.
- Turnover for purpose of levy of CST is equal to Aggregate Sale price minus CST payable.
- CST is payable on excise duty, cesses on goods, packing material, *dharamda* and goods returned beyond 6 months.

- CST is not payable on outward freight, insurance, installation and commissioning and goods rejected. Discounts are excluded for purpose of calculating CST.

CST rate at a glance- The CST rates at a glance as applicable w.e.f. 1-4-2007 are as follows, in case of both declared goods and other goods –

Vat (Sales tax) rate for sale within the State	**CST rate in case of sale to registered dealers (applicable to declared goods as well as other goods)**	**CST rate in case of sale to unregistered dealers (applicable to declared goods as well as other goods)**
Nil	Nil	Nil
1%	1%	1%
2%	2%	2%
3%	3%	3%
4%	3%	4%
8%	3%	8%
10%	3%	10%
12.5%	3%	12.5%
20%	3%	20%

Note – Usually, State Vat rates of 2%, 3%, 8% and 10% do not exist. However, these rates are given only to explain the principle, particularly because UP and Uttaranchal have not introduced Vat.

11.6.1 Goods eligible for purchase at concessional rate in inter-state sale

- Only those goods for which a dealer *is eligible* and which are *contained in his Registration Certificate* are eligible for concessional rate.
- Goods intended for resale, for use in manufacture or processing for sale, for use in telecommunications network, for use in mining, for use in power generation / distribution, *or* containers and packing materials are only eligible for concessional rate.
- 'For use' means 'intended for use'.
- Purchasing dealer has to issue 'C' form to selling dealer to avail concessional rate.

11.6.2 Exemptions from CST

- CST is not payable in case of subsequent sale by transfer of documents if E-I / E-II declarations are given.
- CST is exempt if sale within the State is exempt.
- State Government can exempt CST, but it cannot waive condition of issue of C form.
- Sale in the course of export / import are not taxable.
- Sale to Special Economic Zone (SEZ) and to foreign missions / UN are exempt.

***Sale in course of export* – (a)** Export sale can be direct or by transfer of documents after goods cross customs frontier of India. **(b)** Penultimate sale i.e. sale prior to actual export is exempt if exporter issues H form to supplier [section 5 of CST Act].

***Sale in the course of Import* – (a)** Sale by Agent in India after import of goods is exempt only if there is privity of contract between ultimate buyer and exporter. **(b)** Sale in course of imports by transfer of documents is not taxable **(c)** Sale of goods in customs bonded warehouse is 'sale during import'. **(d)** Sale after import is a distinct sale and sales tax / Vat will be payable.

11.7 GOODS OF SPECIAL IMPORTANCE

Some goods like sugar, textiles, jute, iron and steel, tobacco products have been declared as goods of special importance. State Government cannot levy sales tax on these goods exceeding 4%. If declared goods are sold inter-State, tax paid within the State is reimbursed.

Section 14 of CST Act gives list of 'goods of special importance' called 'declared goods'. Important among them are :

- Cereals i.e. paddy, rice, wheat, bajra, jowar, barley, maize etc.
- Coal and coke in all forms *excluding* charcoal
- Cotton in un-manufactured form but not cotton waste
- Cotton fabrics, cotton yarn
- Crude oil
- Hides and skins
- Iron and Steel i.e. pig iron, sponge iron, iron scrap, steel ingots, billets, steel bars, steel structurals, sheets, plates, discs, rings, tool steel, tubes, tin plates, steel wheels, wire rods; defectives of above etc.
- Jute

- Oil-seeds i.e. groundnut, til, cotton seed, linseed, castor, coconut, sunflower, mahua, kokum, sal etc.
- Pulses i.e. gram, tur, moong, masur, urad etc.
- Man-made fabrics - fabrics of man-made filament yarn i.e. artificial textile materials, polyester filament yarn, staple fibres, polyester staple fibre, tyre cord fabric, impregnated textile fabrics etc.
- Sugar and Khandsari Sugar
- Woven fabrics of wool
- Aviation Turbine Fuel sold to an aircraft with a maximum take-off mass of less than 40,000 kilograms operated by scheduled airlines i.e. airlines permitted by Central Government to operate any scheduled air transport service (entry as substituted w.e.f. 11-5-2007 by Finance Act, 2007. Earlier, the entry read as follows - Aviation Turbine Fuel sold to a turbo-prop aircraft)
- LPG (Liquid Petroleum Gas) for domestic use (inserted w.e.f. 18-4-2006 to maintain tax rates at reasonable level).

Un-manufactured tobacco, cigars, cigarettes, biris, chewing tobacco, snuff etc. have been omitted from the list w.e.f. 1-4-2007. This will enable State governments to impose Vat/sales tax on these products.

11.8 APPEALS AND PENALTY UNDER CST ACT

CST Act is administered by State Government. Appeal and penalty provisions as applicable to State Vat Act apply to CST also. However, following specific provisions have been made under CST Act.

- In case of dispute whether a particular transaction is inter state sale or stock transfer, appeal can be filed with CST Appellate Authority, if the order is made u/s 6A *read with* section 9 of CST Act
- Authority for Advance Ruling (AAR) under Income Tax has been constituted as CST Appellate Authority w.e.f. 17-3-2005
- Such appeal can be filed only on decision of highest Appellate Authority in the State (excluding High Court).
- CST Act makes provisions for punishments for certain offenses. In some cases, compounding is permissible.
- Directors of private limited company in liquidation are liable for payment of CST liability.

11.9 PRESCRIBED FORMS UNDER CST

Following are the forms prescribed under CST (Registration and Turnover) Rules, 1957.

Form	Description	Frequency
A	Application for registration	Once
B	Certificate of Registration	Once
C	Declaration by purchasing registered dealer to obtain goods at concessional rate	To be obtained for every quarter and submitted on quarterly basis
D	Form of certificate for making government purchases (D form cannot be issued in case of sale made to Government on or after 1-4-2007)	No question arises after 1-4-2007
E-I / E-II	Certificates for sale in transit	To be obtained for every quarter and submitted on quarterly basis
F	Form by branch / consignment agent for goods received on stock transfer	Monthly, but to be submitted quarterly
G	Indemnity bond when C form lost	When required
H	Certificate of Export	Upto the time of assessment by first assessing authority.
I	Certificate by SEZ unit	Not specified in rules (but should be submitted before assessment).
J	Certificate to be issued by foreign diplomatic mission or consulate in India or the UN Agency	Upto the time of assessment by first assessing authority.

STUDY NOTE -12

STATE LEVEL VAT

This Study Note includes

- Background of State VAT
- Basic Principle of VAT
- Disadvantages and Pitfalls in VAT
- Overview of State VAT
- Procedural Provisions relating to VAT
- Impact of VAT on CST

12.1 BACKGROUND OF STATE VAT

Tax on sale within the State is a State subject. Over the period, many distortions had come in taxation. Following were some of the problems -

- Unhealthy competition among States by giving sales tax incentives to new industries. When one State gave incentives, others also had to give. This ruined State finances.
- 'Tax rate war' started to attract more revenue to State. Often, goods from the State were sent to another State on stock transfer basis and brought back in the same State to show as Inter-State Sale.
- States introduced 'first point sale' to avoid cascading effect of State sales tax. This made tax evasion easy.
- Cascading effect of tax due to Central Sales Tax.

Discussions with State Governments - Central Government initiated discussions with State Governments in 1995. After lot of persuasion by Central Government, all States ultimately agreed to introduce State Level Vat at the conference of Chief Ministers all States at Delhi in November, 1999.

'Empowered Committee' of State Governments - A high power committee consisting of senior representatives of all 29 States was constituted under Chairmanship of Dr. Asim Dasgupta, Finance Minister, West Bengal. After deliberations and many meetings, it was announced that all States have agreed to introduce VAT w.e.f. 1-4-2005. A 'White paper' was released by Dr. Asim Dasgupta, Chairman of Empowered Committee, on 17-1-2005. The White Paper is a policy document indicating basic policies of State Sales Tax VAT.

CST is proposed to be abolished – Vat is consumption based tax while CST is production based tax. Thus, CST is against principles of Vat. CST has been reduced to 3% w.e.f. 1-4-2007. CST rate is proposed to be reduced by 1% every year and made Nil by 1-4-2010.

Revenue loss if CST rate is reduced - If CST rate is reduced, State finances will suffer, since revenue of Central Sales Tax goes to respective State Government. It is proposed to authorise

State Governments to levy tax on some services like medical, legal and education.

12.1.1 State-wise position of VAT

Haryana was the only State to introduce VAT w.e.f. 1-4-2003. 20 States introduced VAT w.e.f. 1-5-2005. These include Assam, Andhra Pradesh, Bihar, Delhi, Goa, Karnataka, Kerala, Maharashtra, Punjab and West Bengal.

States ruled by BJP like Gujarat, Chhatisgarh, Jharkhand, Madhya Pradesh and Rajasthan introduced Vat w.e.f. 1-4-2006. Tamilnadu has introduced Vat on 1-1-2007.

Uttaranchal has not introduced Vat till November, 2007. UP has introduced Vat w.e.f. 1-1-2008. J&K is not in the picture due to constitutional issues.

Vat system not same in all States - *The VAT system as introduced is result of deliberations of committee of representatives from 29 States. Each State has its own views and peculiarities. Hence, having uniform nationwide Vat is very difficult and some compromises/adjustments are inevitable.*

Vat law not uniform in all States - *Each State has made changes as per their needs. Though basic concepts are same in Vat Acts of all States, provisions in respect of credit allowable, credit of tax on capital goods, credit when goods are sold inter-state are not uniform. Even definitions of terms like 'business', 'sale', 'sale price', 'goods', 'dealer', 'turnover', 'input tax' etc. are not uniform. Schedules indicating tax rates on various articles are also not uniform, though broadly, the schedules are expected to be same.*

12.1.2 *State Vat is diluted version of VAT*

The Vat as introduced, is a diluted version of Vat and some compromises have been made. There is no credit of Central Sales Tax paid on inter-state purchases. This problem will not arise if CST rate is reduced to 0% on 1-4-2010, as planned and inter-state sale is made 'zero rated'.

If goods are sent outside State on stock transfer basis, credit (set off) of tax paid on inputs is available only to the extent of tax paid in excess of 4%. Thus, credit (set off) to the extent of 4% tax on inputs is lost. It is not clear what will be position when CST rate is brought down to Nil. Thus, the VAT as introduced is State Vat and not a national Vat.

12.1. 3 World scenario in respect of Development of 'VAT'

Concept of VAT was developed to avoid cascading effect of taxes. VAT was found to be a very good and transparent tax collection system, which reduces tax evasion, ensures better tax compliance and increases tax revenue.

First introduced in France - Concept of VAT was first conceived by Mr. Maurice Laure, Joint Director of French Tax Authority. Vat (termed as TVA in France) was introduced for the first time in France on 10-4-1954.

Vat in Europe - Vat system got real impetus when European Union (EU) made adopting VAT regime as condition precedent to joining European Common Market. Members of EU (that

time it was European Common Market) were required to introduce common system of Vat *vide* Sixth Council Directive No. 77/388/EEC dated 17-5-1977. This is most important document so far as Vat is Europe is concerned.

Vat is imposed in Europe on both goods and services. Vat rate varies in various member countries of European Union. Minimum is 15% and maximum is 25%. General Vat rate in UK is 17.5%, but there is lower rate of 5% in case of some goods and some goods are exempt.

General Vat rate in some other countries is as follows – Sweden – 25%, Germany – 19%, France – 19.6%.

If goods or services are exported to another EU member country or other country, Vat is not imposed. Vat paid on inputs is granted as refund.

European Union was formed on 1-11-1993. Many countries joined EU later. As in July 2007, 27 countries are part of EU.

Development in other countries - Many countries in Asia, Central America and other parts of Europe have introduced Vat. So far, about 135 countries have introduced Vat.

Vat in China - China introduced in Vat on 24 items in 1984. Later, regulations for VAT Tax were made effective on 1-1-1994 and Vat was extended to all goods and services. The general Vat rate is 17%. Vat rate is reduced to 13% in some cases. There is no Vat on exports.

Consumption tax in Japan – Japan has system of consumption tax, which is levied @ 5%.

No Vat in USA - USA has not introduced Vat. In USA, tax is levied by State Governments on retail sale. The rate varies between 0% to 8.8%. There is no tax on services in USA.

Development in India - In India, Vat was introduced at manufacturing stage under Central Excise in 1986, termed as Modvat (modified value added tax). Modvat was re-named as Cenvat w.e.f. 1-4-2000. System of Vat was introduced in service tax w.e.f. 16-8-2002. Credit of excise duty and service tax was made inter-changeable w.e.f. 10-9-2004. Thus, partial integration of goods and service tax has been achieved. Presently, full integration is not possible since power to levy sales tax is with State Government.

12.2 BASIC PRINCIPLE OF VAT

VAT (Value Added Tax) is a tax on final consumption of goods and services.

VAT works on the principle that when raw material passes through various manufacturing stages and manufactured product passes through various distribution stages, tax should be levied on the 'Value Added' at each stage and not on the gross sales price. This ensures that same commodity does not get taxed again and again and there is no cascading effect. In simple terms, 'value added' means difference between selling price and purchase price. VAT avoids cascading effect of a tax.

Basically, VAT is multi-point tax, with provision for granting set off (credit) of the tax paid at the earlier stage. Thus, tax burden is passed on when goods are sold. This process continues till

goods are finally consumed. Hence, VAT is termed as 'consumption based' tax. It is tax on consumption of goods and services. VAT works on the principle of 'tax credit system'.

Distinction between sales tax and Vat - Basic distinction between Vat and sales tax is that sales tax is payable on total value of goods while Vat is payable only on 'value addition' at each stage.

12.2.1 Cascading effect of tax

Generally, any tax is related to selling price of product. In modern production technology, raw material passes through various stages and processes till it reaches the ultimate stage e.g., steel ingots are made in a steel mill. These are rolled into plates by a re-rolling unit, while third manufacturer makes furniture from these plates. Thus, output of the first manufacturer becomes input for second manufacturer, who carries out further processing and supply it to third manufacturer. This process continues till a final product emerges.

This product then goes to distributor / wholesaler, who sells it to retailer and then it reaches the ultimate consumer. If a tax is based on selling price of a product, the tax burden goes on increasing as raw material and final product passes from one stage to other, as illustrated below, where A sales to B and B sales to C.

Details	A	B	C
Purchases	-	110	165
Value Added	100	40	35
Sub – Total	100	150	200
Add Tax 10%	10	15	20
Total	110	165	220

You will find that B is paying tax not only on his contribution of Rs 40 but also on Rs 100 and Rs 10. Thus, same material gets taxed again and again and there is also tax on tax. As stages of production and / or sales continue, each subsequent purchaser has to pay tax again and again on the material which has already suffered tax. Tax is also paid on tax. This is called *cascading effect*.

12.2.2 Disadvantages of cascading effect of taxes

A tax purely based on selling price of a product has cascading effect, which has the following disadvantages :

- Real tax content in the price of a product cannot be known, as a product passes through various stages and tax is levied at each stage.

- Tax burden on any commodity will vary widely depending on the number of stages through which it passes in the chain from first producer to the ultimate consumer.
- Ancillarisation is discouraged and manufacturer tries to manufacture all parts and do all processes in his plant itself. This increases manufacturing costs.
- End use based exemptions and concessions (e.g. exports or goods consumed by poor) cannot be given since it is not known what were taxes paid in earlier states.
- Exports cannot be made fully tax free.

12.2.3 VAT avoids cascading effect of tax

System of VAT works on tax credit method. In Tax Credit Method of VAT, the tax is levied on full sale price, but credit is given of tax paid on purchases. Thus, effectively, tax is levied only on 'Value Added'. Most of the countries have adopted 'tax credit' method for implementation of VAT.

The aforesaid illustration will work out as follows under VAT system.

'B' will purchase goods from 'A' @ Rs. 110, which is inclusive of duty of Rs. 10. Since 'B' is going to get credit of duty of Rs. 10, he will not consider this amount for his costing. He will charge conversion charges of Rs. 40.00 and sell his goods at Rs. 140. Following example will illustrate the tax credit method of VAT.

	Transaction without VAT		**Transaction With VAT**	
Details	A	B	A	B
Purchases	-	110	-	100
Value Added	100	40	100	40
Sub – Total	100	150	100	140
Add Tax 10%	10	15	10	14
Total	110	165	110	154

Note - 'B' is purchasing goods from 'A'. In second case, his purchase price is Rs 100/- as he is entitled to VAT credit of Rs 10/- i.e. tax paid on purchases. His invoice shows tax paid as Rs 14. However, since he has got credit of Rs 10/-, effectively is paying only Rs 4/- as tax, which is 10% of Rs 40/-, i.e. 10% of 'value added' by him.

Meaning of 'Value added' - *In the above illustration, the 'value' of inputs is Rs 110, while 'value' of output is Rs 150. Thus, the manufacturer has made 'value addition' of Rs 40 to the product. Simply put,*

'value added' is the difference between selling price and the purchase price.

12.2.4 Revenue Neutral Rate

Government was earlier getting tax revenue of Rs 25. In above example, Government gets revenue of only Rs 14. To avoid loss of revenue, rate of tax will have to be suitably increased such that Government gets same revenue as per previous system. This is termed as 'RNR' (Revenue Neutral Rate'). In aforesaid example, RNR will be high i.e. 17.86%.

Practically, since most State Governments had single point sales tax at first level, RNR is not high. In fact, RNR is lower than the earlier sales tax rate since under Vat, tax is realised on final selling price and not the price at the first level.

For example, if earlier sales tax rate was 15% on wholesale price of Rs 100; under VAT system, tax will be collected at consumption stage i.e. on retail price of (say) Rs 140.

It has been decided to levy sales tax at RNR of 12.5% for most of commodities.

What is meant by consumption Types of 'VAT? - 'Consumption based tax' means tax is actually levied only when goods are finally consumed / utilised. Till then, the tax burden is passed on to next buyer.

12.2.5 Advantages of VAT over conventional system of taxation

Advantages of VAT are as follows :

- Tax burden is only at the last i.e. consumption stage. This is useful for taxation structure based on 'destination principle'.
- It becomes easier to give tax concessions to goods used by common man or goods used for manufacture of capital goods or exported goods.
- Exports can be freed from domestic trade taxes.
- It provides an instrument of taxing consumption of goods and services.
- Interference in market forces is minimum.
- Simplicity and transparency.
- Aids tax enforcement by providing audit trail through different stages of production and trade.
- Thus, it acts as a self-policing mechanism resulting in lower tax evasion.
- Tax rates can be lower as tax is levied on retail price and not on wholesale price.

12.3 DISADVANTAGES AND PITFALLS IN VAT

One major disadvantage of Vat is tremendous paper work and record keeping. Vat system can work only if record keeping is proper and reliable. The elaborate record keeping is not possible to small businesses. Hence, exemption is granted to tiny businesses whose turnover is below prescribed limits. In case of small businesses, a composition scheme is provided where tax is paid on gross value of sales at a fixed rate.

Some major problems in Vat are –

- Bogus Invoices on which tax credit is availed, i.e. invoice without actual purchase of goods.
- Acquisition fraud (missing trader fraud).
- Carousel Fraud (missing trader fraud).

Acquisition fraud - The acquisition fraud is based on the fact that goods imported are tax free. A dealer imports goods and makes sale within the country. The dealer either has his own Vat registration number or he hijacks other's Vat number. He collects the tax from buyer and then disappears without paying the collected tax to Government. The buyer is usually innocent and is not aware that the seller is not going to pay tax to Government. This is 'missing trader fraud' of one type.

In Indian context, this fraud is possible when CST rate is Nil or is reduced to 1%. A dealer can purchase goods inter-state and make sale within the State. He will collect tax and then disappear. He may use someone else's vat number in his invoices or may himself get registered with address of some temporary rented premises.

12.3.1 'Carousel fraud' in VAT

'Carousel' means 'merry-go-around' or' roundabout' (Concise Oxford Dictionary). This is 'missing trader fraud' of another type. It is much more involved and difficult to trace. The fraud works as follows –

One dealer 'A' imports goods without tax. He sells goods to 'B' and charges Vat. 'B' avails credit of tax shown by 'A' in his Invoice. 'B' sells the goods to 'C' and charges Vat. Actually, 'B' has to pay only differential amount as tax. 'C' avails credit of tax shown by 'B' in his Invoice. 'C' sells goods to 'D' by charging Vat. Since 'C' has availed credit of Vat paid by 'B', he has to pay only differential amount, which is small. 'D' exports the goods and claims refund of input tax i.e. entire tax shown by 'C' in his Invoice.

This is a legitimate transaction. The missing link is that 'A' actually does not deposit tax to Government. 'A' either has his own Vat registration number or he hijacks other's Vat number. He collects tax and then disappears. Thus, 'D' gets refund of tax which is actually not paid by 'A'!. By the time Government traces the transaction to 'A', he i.e. 'A' has disappeared.

The same goods are used again and again for 'imports' and 'exports'. That is why the fraud is termed as 'carousel' fraud. The high value goods like microchips and mobile phones are generally used for such deals.

UK is said to be main victim of such fraud. It is reported that UK has lost 12.6 billion Euro in such frauds. It is said that fraudsters prefer UK since it has weak and time consuming legal system!

In UK, reverse charge has been introduced in 2006 on tax payable on wholesale sales of mobile phones and microchips to combat the fraud. In 'reverse charge', buyer himself is liable to pay Vat on goods purchased.

Can the fraud work in Indian context? – In Indian context, the fraud can work in inter-state purchases and sales in the same way in which it works in European countries in imports/ exports. The person finally selling the goods outside the State can either claim refund of tax paid on his purchases or can adjust the credit for paying taxes on sales made within the States.

In fact, it is possible that actually, goods may not move. Only documents may move from one State to another!.

What happens if 'D' is innocent and had entered into genuine transaction? - If 'D' is innocent, he cannot be penalised for default of 'A'. One such case has been decided by Court of Justice of European Communities, which is the highest Court of European Union. In *Optigen Ltd* v. *Commissioners of Customs and Excise* 2006 EUECJ C-354/03 (decided on 12-1-2006), it has been held that Government cannot refuse refund in such cases.

In India also, Tribunal has held that a buyer cannot be penalised for default of the seller.

In *Prachi Poly Products* v. *CCE* 2005 (186) ELT 100 (CESTAT SMB), it was held that a genuine buyer is eligible for Cenvat credit, even if the seller-manufacturer did not pay duty.

In *R S Industries* v. *CCE* 2003(153) ELT 114 (CEGAT), the manufacturer supplied goods to buyer on duty paying document. The manufacturer had availed Cenvat credit on inputs fraudulently. It was held that the buyer is not responsible for fraud of supplier and he is entitled to Cenvat credit on basis of a valid duty paying document.

Precautions being taken by State Governments under Vat - State Governments have put up or are in process of putting up check posts at State borders to ensure that all goods entering and leaving State are properly recorded. Though the purpose is sound, it is experience everywhere that such physical barriers increase harassment of honest tax payers while dishonest taxpayers can devise their own ways to hoodwink the system.

12.4 OVERVIEW OF STATE VAT

A 'White paper' was released by Dr. Asim Dasgupta, Chairman of Empowered Committee, on 17-1-2005. The White Paper is a policy document indicating basic policies of State Sales Tax VAT.

The white paper gives background of problems in present system of sales tax, principles of Vat and its advantages. It also gives basic design of State level Vat proposed to be implemented. States have generally followed the principles as given in the White Paper. Of course, there are variations.

Highlights of policy regarding State Vat as contained in White Paper are given below.

Tax Credit - Manufacturer will be entitled to credit of tax paid on inputs used by him in manufacture. A trader (dealer) will be entitled to get credit of tax on goods which he has purchased for re-sale [*para 2.3 of White Paper on State-Level VAT*].

Input Tax Credit - Credit will be available of tax paid on inputs purchased within the State. Credit will ***not*** be available of certain goods purchased like petroleum products, liquor, petrol, diesel, motor spirit (position of furnace oil is not clear in white paper, but many States do not give credit).

No credit is available in case of Inter-State purchases.

Credit of tax paid on capital goods - Credit will be available of tax paid on capital goods purchased within the State. Credit will be available only in respect of capital goods used in manufacture or processing. The credit will be spread over three financial years and not in first year itself. There will be a negative list of capital goods [*para 2.4 of White Paper on State-Level VAT*]

States has deviated from these provisions. In West Bengal and Kerala, it is available in 36 monthly instalments. In Karnataka, it is available in 12 monthly instalments, but value of capital goods should be minimum Rs 10 lakhs. Capital goods of value less than Rs 10 lakhs will be 'inputs' and immediate credit will be available. In Maharashtra, entire credit is available immediately.

Instant credit – Credit will be available as soon as inputs are purchased. It is not necessary to wait till these are utilised or sold [*para 2.3 of White Paper on State-Level VAT*].

No credit of CST paid - Credit of Central Sales Tax (CST) paid on inputs and capital goods purchased from other States will not be available [*para 2.6 of White Paper on State-Level VAT*]. This appears to be discriminatory and violative of Articles 303 and 304(a) of Constitution.

Transitional Credit of stock as at the beginning of Vat Act - Input tax as already paid on goods lying in stock as on the day when Vat was introduced (which are purchased within one year prior to that date) was available to dealer. For example, if Vat was introduced on 1-4-2005, credit of tax paid on stock lying as on 31-3-2005 was allowed if the goods were purchased on or after 1-4-2004.

Detailed stock statement were required to be submitted to sales tax authorities. This credit will be available over a period of six months after an interval of 3 months need for verification [*para 2.7 of White Paper on State-Level VAT*].

States have deviated from these provisions.

Very few sales tax forms – Most of present sales tax forms will disappear. [*para 2.14 of White Paper on State-Level VAT*] However, forms relating to EOU/SEZ may continue. Forms under CST Act will continue.

One to one correlation not required – VAT does not require one to one i.e. Bill to Bill correlation between input and output. Credit is available as soon as inputs/capital goods are purchased.

The credit can be utilised for payment of VAT on any final product. It is not necessary to wait till the input is actually consumed / sold.

Entry tax/Octroi will continue - There is no proposal to extend VAT to entry tax (in lieu of octroi) or Octroi levied by local authorities. These will continue.

12.4.1 Purchase tax in VAT or 'reverse charge'

Though white paper makes no mention of purchase tax, some States like Kerala and Andhra Pradesh have made provision for imposition of purchase tax when purchase is from unregistered dealers. Its credit will be available where vat credit on purchases is available. Thus, in effect, in respect of purchases where Vat credit is not available, purchase tax will be payable.

This is termed as 'reverse charge'.

In UK, reverse charge has been introduced in 2006, on tax payable on sale of mobile phones and microchips.

Reverse charge **-** Normally, Vat is payable by seller of goods. However, in some cases, the liability is cast on the purchaser of goods. This is termed as 'reverse charge'.

This concept is used in service tax also. In reverse charge, the service receiver also acts as service provider. He pays tax on services received by him. He can avail Cenvat credit of tax paid by him, since the service is actually his 'input service'.

There is provision of 'tax collection at source' under section 206C of Income Tax Act. Here, seller of liquor is liable to pay tax at source. The buyer has no liability. Tax deduction at source (TDS) under Income tax is really not 'reverse charge', since basic responsibility of payment of income tax continues to be that of person earning income.

Mode of 'reverse charge' is used when it is administratively difficult to collect tax from seller of goods or service provider or income earner.

12.4.2 Tax rates under VAT

Ideally, VAT should have only one rate. Though this is not possible, it is certain that there should be minimum varieties of rates. Broadly, following VAT rates are proposed [*para 2.18 and 2.19 of White Paper on State-Level VAT*] -

- 0% on natural and un-processed produces in unorganised sector, goods having social implications and items which are legally barred from taxation (e.g. newspapers, national flag). This will contain 46 commodities, out of which 10 will be chosen by individual States which are of local or social importance. Other commodities will be common for all States. Certain specified life saving medicines have been exempted from VAT tax.

- No VAT on Additional Excise Duty items (textile, sugar and tobacco) in first year. Position will be reviewed later. Vat has been imposed by State Governments @ 12.5% on tobacco products w.e.f. 1-4-2007.

- 1% floor rate for gold and silver ornaments, precious and semi-precious stones.
- 4% for goods of basic necessities (including medicines and drugs), all industrial and agricultural inputs, declared goods & capital goods. This will consist of about 270 commodities.
- 12.5% RNR (Revenue Neutral Rate) on other goods.
- Aviation turbine fuel (ATF) and petroleum products (petrol, diesel and motor spirit) will be out of VAT regime. Liquor, cigarettes, lottery tickets, will also be taxed at a higher rate. These will have uniform floor rates for all States (generally 20%). Tax paid on these will not be eligible for input tax credit.

Broadly, VAT rates of all States follow this pattern, but still there are many variations.

For example, in some States, Vat rate on gold and silver ornaments has been reduced to 0.25%, as traders were facing competition from neighboring States. Kerala State has imposed tax @ 20% on some luxury goods, though tax on such goods should be @ 12.5% as per the white paper.

In some States, hand tools are taxed at 4%, while in some States, these are taxed at 12.5%.

Policy about turnover tax, surcharge, additional tax etc. imposed by State Governments - States were levying turnover tax, surcharge etc. on sales tax,. Those taxes on sale will go. However, Octroi and Entry tax (which is in lieu of octroi) will continue. Other type of Entry Tax will either be discontinued or will be made Vatable [*para 2.16 of White Paper on State-Level VAT*] .

12.4.3 Concessions for small dealers

VAT tax will be payable only by those dealers whose turnover exceeds Rs five lakhs per annum. The dealers whose turnover is less than Rs five lakhs can register on optional basis. Dealers having turnover exceeding 5 lakhs should register within 30 days from date of liability to get registered [*para 2.9 of White Paper on State-Level VAT*]

In case of Karnataka, the limit is only Rs two lakhs. Most of States have kept the limit as Rs five lakhs.

Composition scheme for dealers with turnover upto Rs 50 lakhs - Small dealers having gross turnover exceeding Rs five lakhs but less than Rs 50 lakhs have option of composition scheme. They will have to pay a small percentage of gross turnover. They will not be entitled to any input tax credit [*para 2.9 of White Paper on State-Level VAT*]

The percentage has not been announced in white paper, but earlier, it was announced as 1%. This rate has been prescribed in West Bengal VAT Act, AP VAT Act, Delhi VAT Act, Kerala VAT Act and Karnataka VAT Act.

In case of Karnataka, composition scheme is available only to a dealer whose turnover in a period of four consecutive quarters does not exceed Rs 15 lakhs.

In Maharashtra, tax payable under composition scheme is 8% of difference between value of turnover of sales less value of turnover of purchases including tax (other than excluded goods) (in short, it is 8% of gross margin of trader). Second hand car dealer is required to pay sales tax @ 4%. In case of works contract, tax can be paid @ 8% of total contract value after deducting amount payable towards sub-contracts to the sub-contractors.

Dealers who make inter-State purchases are not eligible for the composition scheme. This provision applies to VAT law of almost all States.

The scheme is optional. They can opt to pay normal VAT tax and avail credit of input tax.

Composition scheme is a practical scheme considering ground realities, though it dilutes the basic concept of vat that tax is payable at consumption stage. Of course, such schemes are provided in almost all Vat regimes prevailing in Europe and elsewhere, considering practical difficulties in assessing and collecting tax from small traders.

12.4.4 Where input credit will not be available

Credit of tax paid on inputs will be denied in following situations -

No credit if final product is exempt - Credit of tax paid on inputs is available only if tax is paid on final products. Thus, when final product is exempt from tax, credit will not be availed. If availed, it will have to be reversed on *pro-rata* basis.

Restricted credit if output goods are transferred to another State - If the final products are transferred to another State as stock transfer or branch transfer, input credit availed will have to be reversed on *pro-rata* basis, which is in excess of 3%. In other words, in case of goods sent on stock transfer / branch transfer out of State, 3% tax on inputs will become payable e.g. if tax paid on inputs is 12.5%, credit of 9.5% is available. If tax paid on inputs is 3%, no credit is available (This is termed as 'retention'). Thus, the VAT as introduced is State Vat and not a national Vat (In case of some States, even if CST is reduced to 3%, retention has been kept @ 4% only).

No input credit in certain cases - In following cases, the dealer is not entitled to input credit - (a) Inputs used in exempted final products (b) Final product not sold but given as free sample (c) Inputs lost / damaged / stolen before use. If credit was availed, it will have to be reversed.

No credit on certain purchases – Generally, in following cases, credit is not available – (a) Purchase of automobiles (except in case of purchase of automobiles by automobile dealers for re-sale) (b) fuel.

There are variations between provisions of different States.

12.4.5 Distinction between 'Zero rated sale' and 'exempt sale'

Certain sales are 'zero rated' i.e. tax is not payable on final product in certain specified circumstances. In such cases, credit will be available on the inputs i.e. credit will not have to be re-

versed. Distinction between 'zero rated sale' and 'exempt sale' is that in case of 'zero rated sale', credit is available on tax paid on inputs, while in case of exempt goods, credit of tax paid on inputs is not available.

As per para 2.5 of White Paper on State-Level VAT, export sales are zero rated, i.e. though sales tax is not payable on export sales, credit will be available of tax paid on inputs.

In respect of sale to EOU / SEZ, there will be either exemption of input tax or tax paid will be refunded to them within three months. If supplies to EOU / SEZ are exempt from sales tax, then the question will arise whether these are 'zero rated' or 'exempt goods'.

In case of stock transfer to another State, CST is not payable, but input credit will have to be reversed to the extent of 3%. Thus, stock transfer of goods to another State is 'exempt' and not 'zero rated'.

It is not clear what will be the policy after CST is reduced to 2% or when CST is reduced to zero. As per basic concept of Vat, inter-state transactions should be 'zero rated' and not 'exempt'.

12.4.6 Refund if VAT credit of input tax available cannot be utilised for any reason

Entire input tax will be refundable within three months, when final product is exported. In respect of sale to EOU / SEZ, there will be either exemption of input tax or tax paid will be refunded within three months [*para 2.5 of White Paper on State-Level VAT*].

If tax credit exceeds tax payable on sales, the excess credit will be carried to end of next financial year. Excess unadjusted credit at end of second year will be eligible for refund [*para 2.4 of White Paper on State-Level VAT*]

Such excess credit can arise when purchases of inputs are made locally, but final product is mainly exported or stock transferred to another State.

12.4.7 Exemptions and incentives to new industries already granted to continue

All State Governments were offering sales tax incentives to new industries set up in the State. The incentives were broadly of three types - (a) Exemption - Don't charge tax and don't pay (b) Deferral - Charge sales tax in invoice but pay after long period of (say) 12 to 18 years (c) Remission - Charge in the invoice but retain and do not pay to Government. - - State Governments have stopped giving incentives to new industries after January, 2000. However, there are commitments in respect of industries set up prior to January, 2000. State Governments to continue with the incentives which were already granted [*para 2.15 of White Paper on State-Level VAT*). [Some States may allow industries under exemption scheme to convert to deferral scheme so that such industries can pass on benefit of VAT to their buyers].

12.5 PROCEDURAL PROVISIONS RELATING TO VAT

A system of audit checks will have to be established to keep check on bogus invoices. One essential requirement is to give TIN (Tax Identification Number) to all registered dealers, so that a check is maintained that (a) The tax as shown in the invoice has indeed been paid (b) There is no double credit on basis of same invoice. TIN will have to be indicated on each in-

voice issued. It will be a 11 digit numerical code. First two digits will indicate State Code [*para 2.10 of White Paper on State-Level VAT*] .

Thus, State level computer network with check based on TIN will be established. Otherwise, misuse will be rampant.

Documentation required to avail credit of tax paid on inputs and capital goods - Tax credit will be given on basis of document, which will be a 'Tax Invoice', cash memo or bill. Such invoice can be issued only by a registered dealer, who is liable to pay sales tax. The invoice should be serially numbered and duly signed, containing prescribed details. The tax payable should be shown separately in the Invoice. The dealer should keep counterfoil / duplicate of such invoice duly signed and dated [*para 2.8 of White Paper on State-Level VAT*]

In case of manufacturer, Invoice issued under Central Excise Rules should serve purpose of VAT also, if the invoice contains required particulars.

Dealers availing composition scheme shall not show any tax in their invoice. They are not entitled to any credit of tax paid on their purchases.

Debit note and credit note - If sale price is increased / reduced subsequent to sale, the transaction will be recorded through proper debit / credit note. The buyer will adjust the input credit available to him accordingly.

12.5.1 Records and Accounts

Each State has prescribed records to be maintained. Broadly, following records will be required.

- Records of purchases of Inputs.
- Record of debit notes and credit notes.
- Quantity record of inputs.
- Record of credit notes received from supplier.
- Record of capital goods.
- Sale register and tax charged on sales.

Record of Tax credit available - Monthly / quarterly totals of the following should be taken - (a) Input credit available (b) Credit available on capital goods (c) Credit notes from suppliers.

Carry forward/refund of tax credit - If input tax credit cannot be utilised in a particular month / year, the credit can be carried forward and used in subsequent months / year. Refund of such excess credit is permitted only if goods were exported out of India. If credit is not utilised in two years, refund will be granted.

Preservation of records - Since assessment can be opened for prescribed period (usually five to eight years), it is necessary to preserve all relevant records for prescribed period from close of the financial year. The records can be audited by departmental audit party.

12.5.2 Payment of VAT Tax and filing of returns

Every dealer is required to file returns on monthly / quarterly basis. If the records are kept properly, filing the return will be very easy and mistakes will be minimum.

Net Tax payable - Net tax payable will have to be calculated as follows - (a) Output tax *plus* (b) Reversal of Credit (On exempted goods, stock transfers, free samples, lost inputs) - *Less* - (c) Input tax credit available.

This net amount is required to be paid through prescribed challan on or before due date.

12.5.3 Accounting treatment of VAT

ICAI has issued Guidance Note on Accounting for State level VAT on 15-4-2005. The guidance note is based on principles of VAT as contained in White paper released on 17-1-2005. However, there are variations in respect of each State. Hence, accounting policies will have to be adopted to suit provisions of VAT law of the particular State. Following broad principles should be kept in mind -

- As per AS-2, cost of purchase for purpose of inventory valuation should not include tax, if credit of tax paid is available.
- For purpose of income tax, inventory valuation should be inclusive of taxes, even if its credit is available, as per section 145A of Income Tax Act.
- Purchase account should be debited with net amount. VAT credit receivable on purchases should go to 'VAT Credit receivable (Input) Account.
- Account of each rate i.e. 0%, 1%, 4%, 12.5% etc. is required to be kept separately.
- In case of capital goods, as per AS-10, cost of fixed assets should include only non-refundable duties or taxes.
- If entire credit of tax on capital goods is not available immediately, the credit that is available immediately should be debited to VAT Credit Receivable (Capital Goods) Account and credit which is not available immediately should be taken to 'VAT Credit Deferred Account'.
- In case of sales, the sales account should be credited only with net amount (i.e. exclusive of VAT). Tax payable should be credited to separate account 'VAT Payable Account' [This is 'exclusion method'. Interestingly, in case of excise duty paid on final product, 'inclusive method' is permitted, i.e. sale account is credited inclusive of excise duty on final product].
- If any VAT is payable at the end of period (after adjusting VAT credit available), the balance is to be shown as 'current liability'.

12.5.4 Assessment of TAX

Dealer is required to assess his tax and pay himself. It will be basically self assessment. There will be no compulsory assessment at end of the year. If notice is not issued within prescribed time, dealer will be deemed to have been self assessed [*para 2.12 of White Paper on State-Level VAT*]

Returns will be filed monthly/quarterly, as prescribed, along with challans. Returns will be scrutinised and if there is technical mistake, it will have to be rectified by dealer [*para 2.11 of White Paper on State-Level VAT*]

As per West Bengal VAT Act, if dealer does not receive any intimation within two years from end of the accounting year, it is deemed that his return has been accepted by sales tax authority. In case of Andhra Pradesh, the time limit is four years from date of filing of return.

Audit of records **-** There will be audit wing in department and certain percentage of dealers will be taken up for audit every year on scientific basis. The audit wing will be independent of tax collection wing, to remove bias. There will be cross verification with Central Excise and Income Tax also. [*para 2.13 of White Paper on State-Level VAT*]

Audit by outside Agencies – VAT laws of some States provide for audit by outside agencies. AP Vat Act provides for audit by CA, cost Auditor or Sales tax Practitioner (STP), if audit is ordered by Commissioner.

In Karnataka, audit report is required if turnover exceeds Rs 25 lakhs.

In Delhi, the dealer is required to submit copy of audit report u/s 44AB of Income Tax Act (This report is required when turnover exceeds Rs 40 lakhs per annum) No separate audit is prescribed, unless special audit is ordered by department.

In Maharashtra, audit report from Chartered Accountant or Cost Accountant is required if sales turnover exceeds Rs 40 lakhs.

12.6 IMPACT OF VAT ON CST

The provisions in respect of Central Sales Tax are summarised below –

- Para 4.3 of White Paper on State-Level VAT had stated that present CST rate (that time it was 4%) will continue for some time. CST may go after decision in respect of loss of revenue to States is taken and comprehensive Taxation information System is put in place. Accordingly, CST rate has been reduced to 3% w.e.f. 1-4-2007.
- Present CST forms i.e. C, D, E-I/E-II, F, H, I and J will also continue.
- There will be no credit of CST paid on inter-state purchases [para 2.6 of White Paper on State-Level VAT].
- If goods are sent on stock transfer outside the State, input tax paid in excess of 4% will be allowed as credit. In other words, input tax to the extent of 4% will not be allowed as credit

if goods are sent inter-state (The CST rates has been reduced to 3% w.e.f. 1-4-2007. The dis-allowance should also be reduced to 3%. It is not known whether all State Governments are reducing the dis-allowance i.e. 'retention').

Unfortunately, the way sales tax VAT is to be implemented by States, it is only local (i.e. State) VAT and not national VAT. This is because –

(a) If goods are purchased from another State, credit (set off) of CST paid in other State will not be granted by the State where the goods are consumed / used / sold.

(b) If goods are sent to another State on stock transfer basis, only restricted input credit will be given, i.e. there will be no credit on first 4% tax paid on inputs.

Obviously, this is against basic concept of VAT. Thus, the State Level VAT is a truncated version of VAT. It can at the most be termed as 'Local Sales Tax VAT' and not 'National Sales Tax VAT'.

12.6.1 Discriminatory treatment to CST

Provision of not granting credit of CST seems discriminatory. Article 303 of Constitution of India provides as follows, 'Neither Parliament nor the Legislature of State shall have power to make any law giving any preference to one State over another, or making any discrimination between one State and another'.

As per Article 304(a), State Government can impose tax on goods imported from other States, but cannot discriminate between goods imported from other States and goods manufactured within the State.

Kelkar Committee in para 7.2 of its final report submitted in December 2002, has expressed apprehensions about legal implications of Article 304(a) in State Level VAT. The Kelkar Committee has expressed apprehension that investment decisions will tend towards States where the market within the State is larger than outside.

Giving credit only for locally purchased goods appears to be discriminatory and it appears that this will discourage inter-state purchases.

States indirectly taxing inter-state transaction - If goods sent on stock transfer basis, credit will be granted only in excess of 4% tax paid on inputs. Thus, indirectly, tax will be levied on stock transfers.

As per Article 286, State Government cannot impose tax on sale or purchase during imports or exports; or tax on sale outside the State. It means that State Government can impose sales tax only on sale within the State.

12.6.2 Will inter-state sale be zero rated?

The Vat system will be Vat compliant if inter-state sale or stock transfer is 'zero rated' i.e. no tax will be payable on inter-state sale or stock transfers, but entire credit of taxes paid on inputs and capital goods is available. If CST is reduced to Nil, but restricted credit of tax paid inputs is available, then the inter-state sales will be 'exempt' and not 'zero rated'. Then the Vat system will not be as per principles of Vat.

The intention seems to be to make inter-state sales 'zero rated' and not merely 'exempt'. However, white paper issued by Empowered Committee does not categorically say so.

STUDY NOTE - 13

OVERVIEW OF INCOME TAX

This Study Note includes

- Income Tax Liability
- Rate of Income Tax Payable
- Income from Salary
- Income from House Property
- Profit and Gain from Business or Profession
- Other Important Provision in respect of Business Income
- Capital Gains
- Income from other Sources
- Rebate / Exemptions from Income Tax Liability
- Other Provisions of Income Tax
- Income Tax Returns

13.1 INCOME TAX LIABILITY

The legal position discussed is as applicable for financial year 2007-08 (Assessment Year 2008-09) unless specified otherwise.

Income tax is levied under Entry No. 82 of List I of Seventh Schedule to Constitution (Union List), which reads, 'Tax on income other than agricultural income'. Entry No. 46 of List II of Seventh Schedule to Constitution (State List) reads, ' Taxes on agricultural income '.

Income Tax Act, 1961 imposes tax on income other than agricultural income. Tax on agricultural income can be imposed only by State Governments.

Section 4 of Income Tax Act, which is the charging section, states that where any Central Act enacts that income tax shall be charged for any assessment year at any rate or rates, income tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions (including provisions for the levy of additional income tax) of this Act (i.e. Income Tax Act) in respect of the total income of the previous year of every person.

Income tax Rates fixed under Finance Act every year - The 'Central Act' as referred to in section 4 of Income Tax Act is the 'Finance Act' enacted every year. Income Tax is payable by every assessee at the rates prescribed by Finance Act every year. The Finance Bill is presented at the time of presenting Budget, usually on last day of February every year. The relation between Finance Act and Budget is so close that often people associate budget only with taxation. Really, taxation is only one of the aspects of the Budget.

13.1.1 ***Who is assessee ?*** -Assessee means a person by whom any tax or any other sum of money is payable under Income tax Act. It includes deemed assessee [section 2(7) of Income Tax Act]

'Person' includes * Individual * HUF * Company * Partnership Firm * Association of Persons (AOP) or body of individuals whether incorporated or not * Local Authority like Municipality etc. * Artificial Judicial person not falling in any of the aforesaid categories e.g. a Hindu deity [section 2(31) of Income Tax Act]

13.1.2 ***Different heads of income*** - All income is classified under following heads of income - *

Salaries * Income from House property * Profits and gains of business or profession * Capital Gains * Income from other sources (e.g. interest on securities, lotteries, races) [section 14 of Income Tax Act]

Calculation of income tax - Income from each of these sources is first calculated. All this income is added to find out total income of the assessee. Permissible deductions are reduced and then income-tax payable is calculated at the prescribed rates.

Income from one head can be set off against loss from other head, unless specifically prohibited. In *Rajasthan State Warehousing Corporation* v. *CIT* 2000 AIR SCW 629, it was held that if income is derived from various heads, assessee is entitled to claim deduction permissible under respective head whether or not computation under each head results in taxable income. If income to assessee arises under any of the heads of income but from different items e.g. different house properties or different securities etc., and income from one or more items alone is taxable whereas income from the other item is exempt under the Act, the entire permissible expenditure in earning the income from that head is deductible. - . - If assessee carries business in various ventures, entire expenditure incurred on all ventures is deductible if all ventures constitute one business

13.1.3 ***Previous Year and Assessment Year*** - One very confusing aspect of Income Tax for a common man is the difference between Previous Year and Assessment Year.

Assessment year means the period of twelve months commencing on the 1st day of April every year [section 2(9) of Income Tax Act]

Previous year means the financial year immediately preceding the assessment year. If a business / profession is newly set up, previous year is the period from date of setting up that business or profession and ending with the financial year [section 3 of Income Tax Act]

The Financial Year for income tax purposes (called 'Previous Year') is always the year ending 31st March. The 'assessment year' is next to the 'Financial Year' or 'Previous Year' e.g. for Financial Year (FY) 2007-08 (1st April 07 to 31st March 2008), the 'Assessment Year' (AY) is 2008-09.

It may be noted that an assessee can have separate accounting year for his own purposes e.g. a Company can close its accounts on any day of the year, an individual may start his year on Diwali or any other auspicious day. However, for income tax purposes, the accounts must be closed only on 31st March.

Broad mode of computation of Income

		Rs.
1	Income from salaries, allowances and perquisites	
2.	Less : Deduction under section 16, entertainment allowance and professional tax:	
3.	Taxable income under the head "Salaries" (1-2)	.
4.	Income from house property - Adjusted net annual value	
5.	Less : Deductions under section 24	
6	Taxable income under the head Income from house property (5-6)	

7.	Profits and gains of business or profession - Profit / loss as per P&L account after deducting amounts not allowable as deduction, adding amounts which are allowable as deduction and adding income taxable under this head, though not credited / debited to P&L account	
8.	Less : Incomes which are credited to P & L A / c but are exempt under sections 10 to 13A or are taxable under other heads of income	
9.	Taxable income under the head Profits and gains of business or profession (7-8)	
10.	Capital gains	
11.	Less : Amount exempt under sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G and 54GA	
12	Taxable income under the head Capital gains (10-11)	
13	Income from other sources	
14.	Less : Deductions under section 57	
15	Taxable income under the head Income from other sources (13-14)	
16.	Total Income (3+6+9+12+15)	
17	Less : Adjustment on account of set-off and carry forward of losses	
18.	Less : Deductions under sections 80C to 80U	
19	Total income or net income liable to tax (16-17-18)	
20	Income subject to special rate of tax (e.g. capital gains)	
21	Balance income subject to normal rate (20+21 = 19)	

	Computation of tax liability	
A1.	Tax on net income at special rates	
A2	Tax on income at normal rates	
B	Less : Rebate under section 88E	
C	Add : Surcharge	
D	Add: Education cess and secondary and higher education cess	
E	Less : Rebate under sections 86, 89, 90, 90A and 91	
F	Net Tax payable (A1+A2-B+C+D-E)	
G	Tax paid on self-assessment	
H	Tax deducted or collected at source	
I	Tax paid in advance	
J	Balance Tax payable (F-G-H-I)	
		_____

13.2 RATE OF INCOME TAX PAYABLE

Major types of assessees and the tax payable is summarised here.

13.2.1 ***Individual*** - An individual may get income from salary, house rent, business, profession, interest etc. He does not have to pay income tax on dividend income at all. An individual may carry out business under some different name. However, this is only for convenience of business or trade. The income of a proprietary firm is added to his income for purpose of income tax. If a person gets salary from a partnership firm where he is a partner, the income is treated as 'business income' though termed as 'salary'.

The income tax rates are as follows :

Tax rates for the assessment year 2008-09 are as follows -

For resident woman (who is below 65 years at any time during the previous year) –

Net income	***Income-tax rates***
Up to Rs. 1,45,000	*Nil*
Rs. 1,45,000 – Rs. 1,50,000	10% of (total income *minus* Rs. 1,45,000)
Rs. 1,50,000 – Rs. 2,50,000	Rs. 500 + 20% of (total income *minus* Rs. 1,50,000)
Rs. 2,50,000 – Rs. 10,00,000	Rs. 20,500 + 30% of (total income *minus* Rs. 2,50,000)
Above Rs. 10,00,000	Rs. 2,45,500 + 30% of (total income *minus* Rs. 10,00,000) plus 10% of income tax as surcharge

For resident senior citizen (who is 65 years or more at any time during the previous year) –

Net income range	***Income-tax rates***
Up to Rs. 1,95,000	*Nil*
Rs. 1,95,000 – Rs. 2,50,000	20% of (total income *minus* Rs. 1,95,000)
Rs. 2,50,000 – Rs. 10,00,000	Rs. 11,000 + 30% of (total income *minus* Rs. 2,50,000)
Above Rs. 10,00,000	Rs. 2,36,000 + 30% of (total income *minus* Rs. 10,00,000) plus 10% of income tax as surcharge

For any other individual, every HUF / AOP / BOI / artificial juridical person –

Net income range	***Income-tax rates***
Up to Rs. 1,10,000	*Nil*
Rs. 1,10,000 – Rs. 1,50,000	10% of (total income *minus* Rs. 1,10,000)
Rs. 1,50,000 – Rs. 2,50,000	Rs. 4,000 + 20% of (total income *minus* Rs. 1,50,000)
Rs. 2,50,000 – Rs. 10,00,000	Rs. 24,000 + 30% of (total income *minus* Rs. 2,50,000)
Above Rs. 10,00,000	Rs. 2,49,000 + 30% of (total income *minus* Rs. 10,00,000) plus 10% of income tax as surcharge

Notes:

1. Surcharge - Surcharge is 10 per cent of income-tax if net income of an individual, Hindu undivided family, association of persons, or body of individuals, exceeds Rs. 10,00,000. If a person, having taxable income exceeding Rs. 10,00,000, is eligible for tax rebate under section 88E, then you have to calculate income-tax on his income, then from the tax so calculated deduct tax rebate under section 88E. 10 per cent of the balancing amount is surcharge. In the case of an artificial juridical person, surcharge is 10 per cent of income-tax (*i.e.,* income-tax *minus* rebate under section 88E), even if net income is less than Rs. 10,00,000.

Marginal relief - In the case of the aforesaid person having a net income of exceeding Rs. 10,00,000, the net amount payable as income-tax and surcharge shall not exceed the total amount payable as income-tax on total income of Rs. 10,00,000 by more than the amount of income that exceeds Rs. 10,00,000.

2. Education cess and SAH Education Cess - Education cess is 2 per cent of income-tax (after rebate under section 88E) and surcharge. Secondary and higher education cess is 1 per cent of income-tax (after tax rebate under section 88E) and surcharge.

13.2.2 *HUF* - An Hindu Undivided Family (HUF) consists of all persons lineally descended from a common male ancestor. It is assessable in respect of income derived from the joint family corpus. However, income earned by individual members of HUF in their individual and personal capacities is taxed as their personal income. Such income is not treated as income of HUF. Thus, it is possible to have an income from a proprietary firm (in individual capacity) as well as income from a business of HUF. Both are eligible for separate tax exemptions. Business of HUF can, of course, be conducted in a different name. In such case, the HUF will be proprietor of the firm in the name of which business is being conducted.

It may be noted that there is no question of 'forming' an HUF, as every male Hindu automatically has 'HUF'. A Hindu male can have his own separate HUF even if his father or son has separate HUF. One HUF with only one male member is permissible. Any 'HUF' can have business run by head of the HUF called '*karta*'.

If an individual throws his separate property into the property of HUF, income from such converted property will be included in the total income of such individual. Hence, the HUF business should be from independent source of capital and not from the funds provided by an individual member of the HUF. Thus, if an HUF intends to conduct a business, its financial resources have to be carefully planned.

HUF should start business with loans / gifts from unrelated persons / bankers. Accounts and finances of HUF business should be kept separate. Otherwise, there is a possibility that income of HUF will be clubbed with the income of an individual.

The income of HUF is chargeable at the same rate as individual income as stated above. Thus, if an individual splits his business - partly in his individual capacity and partly in name of firm owned by HUF, considerable tax saving is possible, if done systematically and carefully.

13.2.3 ***Partnership Firm*** - Income of the partnership firm has to be calculated after deducting salary and interest payable to partners at prescribed rates. Specific provisions in respect of partnership firm have been explained later.

A firm is taxable at the rate of 30 per cent for the assessment year 2008-09. Surcharge @ 10 per cent of income-tax [*i.e.*, income-tax after rebate under section 88E] is payable, if net income exceeds Rs. 1 crore. Marginal relief is available where net income exceeds Rs. 1 crore. In addition, Education cess is 2 per cent of income-tax (after rebate under section 88E) and surcharge. Secondary and higher education cess is 1 per cent of income-tax (after tax rebate under section 88E) and surcharge.

13.2.4 ***Company*** - The tax on income is 30% for Indian company and 40% for foreign companies for assessment year 2008-09. Surcharge @ 10 per cent of income-tax [*i.e.*, income-tax after rebate under section 88E] is payable, if net income exceeds Rs. 1 crore. Marginal relief is available where net income exceeds Rs. 1 crore. In addition, Education cess is 2 per cent of income-tax (after rebate under section 88E) and surcharge. Secondary and higher education cess is 1 per cent of income-tax (after tax rebate under section 88E) and surcharge.

Dividend Distribution Tax - A domestic company paying dividend will have to pay dividend distribution tax u/s 115-O. The rate applicable w.e.f. 1-4-2007 is 15% plus surcharge @ 1.5% plus education cess @ 2% plus SAH education cess of 1% of income tax. Total 16.995%.

Dividend distribution tax is payable within 14 days from date of declaration/distribution/payment of dividend whichever is earlier. The dividend will be tax free at the hands of assessees.

Mutual funds have to pay dividend distribution tax u/s 115R of Income Tax Act. The rate as applicable w.e.f. 1-4-2007 is 12.5% on income distributed to any individual or HUF and 20% on income distributed to any other person. In addition, surcharge, education cess @ 2% and SAH education cess @ 1% will be payable. Total is 14.1625% in case of individual or HUF unit holder and 22.66% in other cases.

In case of money market mutual fund or a liquid fund, rate is 25%. Including surcharge and education cess, it is 28.325%.

The dividend will be tax free at the hands of assessees.

Income distributed to unit holders of open ended equity oriented funds or US 64 is exempt from dividend distribution tax.

13.2.5 Minimum Alternate Tax

Many companies charge depreciation in their books on straight line method. Thus, the profit shown is higher in the accounts maintained for company law purposes and they can declare dividend. However, for income tax purposes, they charge depreciation on WDV which is higher. Thus, for income tax purposes, they may show low profit or even loss, while in balance sheet prepared for company law purposes, they will show high profits, which is called 'book profits. Hence, such companies have to pay minimum income tax [section 115JB]. This tax is termed as 'Minimum Alternate Tax' (MAT).

In *Apollo Tyres* v. *CIT* (2002) 122 Taxman 562 (SC 3 member bench), it was held that the assessing officer cannot reopen the accounts certified by auditors and adopted in general meeting. He has limited powers of making additions and reductions as provided in the section. [In this case, it was held that assessing officer cannot add back the depreciation for earlier years provided in accounts].

Rate of minimum alternate tax, as % of book profit is as follows, for Assessment Year 2008-09.

	If book profit does not exceed Rs. 1 crore			*If book profit exceeds Rs. 1 crore*			
	IT %	*EC and SAHC %*	*Total*	*IT*	*SC*	*EC and SAHC*	*Total*
Domestic company	10	0.3	10.30	10	1	0.33	11.33
Foreign company	10	0.3	10.30	10	0.25	0.3075	10.5575

Marginal Relief - If book profit of a company for the assessment year 2008-09 exceeds Rs. 1 crore, the minimum alternate tax cannot exceed the following : (Rs. 10 lakh + Book profit – Rs. 1 crore) + EC + SAHC.

13.2.6 ***Co-operative societies*** - Following rates are applicable to a co-operative society for the assessment year 2008-09 -

Net income	Rate of income-tax
Up to Rs. 10,000	10
Rs. 10,000 - Rs. 20,000	20
Rs. 20,000 and above	30

No surcharge applies, but education cess @ 2% of tax and SAH education cess @ 1% of tax is payable.

Various exemptions are available to cooperative societies u/s 80P of Income Tax Act. However, there is no exemption to urban cooperative banks.

13.2.7 ***Local authorities*** - Tax rate is 30%. No surcharge applies, but education cess @ 2% of tax and SAH education cess @ 1% of tax is payable.13.2-7 Capital gains

The rates are 10% for short term capital gains and 20% for long term capital gains for AY 2008-09.

Surcharge for AY 2008-09 is 10% in case of (a) individual / HUF / BOI / AOP if income exceeds Rs 10 lakhs and (b) in case of company / firm if income exceeds Rs one crore. In addition, education cess @ 2% of tax and SAH education cess @ 1% of tax is payable.

13.2.8 ***Wealth-tax*** - Wealth tax for individual, HUF or a company is 1% in respect of wealth over Rs 15 lakhs. There is no surcharge or education cess.

One house or part of house belonging to an individual or HUF is excluded for purpose of wealth tax. The assets have to be valued as per Valuation Rules.

13.3 INCOME FROM SALARY

Income under the head 'salary' comprises of remuneration in any form (including perquisites) received by an employee from employer. Thus, there should be contractual employer-employee relationship. The contract may be express, oral or implied.

Salary is chargeable on due or receipt basis. Arrears of salary paid or allowed are includible if not charged to income tax for any earlier previous year [section 15 of Income Tax Act]

'Salary' includes * wages * dearness allowance * Bonus * gratuity * annuity or pension * advance of salary * Fees / Commissions perquisites / profits received from employer in addition to salary * Leave encashment while in service * Employer's contribution to provident fund in excess of 12% of salary of employee * profit in lieu of salary [section 17(1) of Income Tax Act]

In *Karamchari Union* v. *UOI* 2000 AIR SCW 806 = AIR 2000 SC 1226 = (2000) 109 Taxman 1 = 2000 LLR 897 = 243 ITR 143 (SC), it has been held that CCA (City Compensatory Allowance), DA (Dearness Allowance) and HRA (House Rent Allowance) are in nature of income forming part and parcel of salary and are taxable.

13.3.1 Allowances

House rent allowance - Exemption will be *lowest of* (a) 50% of salary where residential accommodation is in Mumbai, Kolkata, Delhi or Chennai and 40% of at other place (b) Excess of rent paid over 10% of salary (c) Actual allowance paid. There will be *no exemption* if the residential accommodation is owned by employee or employee has not paid any rent for residential accommodation used by him [section 10(13A) of Income Tax Act and rule 2A]

Salary means basic plus DA (if forming part of retirement benefits) plus commission (if fixed as a percentage of turnover).

Gratuity - Gratuity for Government employees is fully exempt [section 10(10)(i)]. In case of employees covered under Payment of Gratuity Act, exemption is upto Rs 3,50,000 to be reduced by such exemptions claimed in the past or 15 days salary for every completed year of service, whichever is lower.. Salary means basic plus DA (if forming part of retirement benefits) [section 10(10)(ii) of Income Tax Act] Any other gratuity is also exempt to same extent [section 10(10(iii)]of Income Tax Act]

Leave encashment - Encashment of earned leave on retirement of employees of Central / State Govt is fully exempt [section 10(10AA)(i) of Income Tax Act] . Leave encashment while in service is treated as part of salary. In other cases, leave encashment of earned leave on retirement will be lowest of 10 months' salary, Rs three lakhs or actual sum received [section 10(10AA)(ii) of Income Tax Act]

LTA/LTC - Leave Travel Assistance / Leave Travel Concession is allowed twice in a block of four years. It is limited to amount actually spent on travelling of employee and his family members. It is limited to economy class of air fare or AC first class fare [section 10(5) of Income Tax Act and rule 2B]

The allowance is exempt subject to amount of expenses actually incurred by the employee for such travel. The employee will have to keep account of actual expenses incurred. It appears that actual travel by air or AC is not required, but the overall ceiling on expenses is subject to limit of air fare / rail fare.

VRS (Voluntary Retirement) - It is exempt upto Rs five lakhs if VRS is as per prescribed conditions.

Medical treatment - Reimbursement of amount actually spent for medical treatment upto Rs 15,000 is exempt in a financial year. In addition, reimbursement of insurance premium for self, spouse, children and dependent brothers, sisters and parents is exempt.

In case of treatment in Government or approved hospital, or expenditure on medical treatment outside India, reimbursement of medical expenses is exempt without any ceiling.

13.3.2 ***Valuation of perquisites*** - The employer often gives some perquisites to the employees. Value of these perquisites is added to the income of employees. The valuation of perquisites is done as follows :

Rent Free unfurnished Accommodation - - In case of private sector employees, value of perquisite of rent free unfurnished accommodation is taken as follows - (a) If owned by employer - If population of city exceeds 25 lakhs - 15%, if population exceeds 10 lakhs but below 25 lakhs - 10% (c) In other cases - 7.5%.

In case of Government Employees, value will be rent as per rules framed by Government, as reduced by sum actually paid

Salary includes basis, DA (if taken into account for retirement benefit), bonus, commission, fees and all taxable allowances.

Valuation of furnished accommodation - If accommodation is furnished, in addition to above, 10% of cost of furniture (including TV, radio, refrigerator, AC etc.), if owned by employer, will be treated as perquisite. If the furniture is hired from third party, actual hire charges less any amount recovered from employee will be the perquisite.

Gas electricity or water supply - Some benefits like gas, electricity, water are valued at actual cost to employer. If these are provided from own sources, value will be manufacturing cost

incurred per unit, less amount recovered from employee.

Domestic servants - Actual cost to employer for sweeper, gardener, watchman or personal attendant will be value of perquisite.

Use of movable assets - If some movable asset is provided to employee, perquisite will be @ 10% of the cost of asset or rent paid, as reduced by sum paid by employee.

Loans to employees at concessional rate - Calculate interest on basis of SBI lending rates, reduced interest paid by employee and difference will be the value of perquisite.

13.3.3 Perquisites which will not be added to salary if employer covered under FBT

Remaining perquisites will be considered as Fringe Benefit and will be considered for FBT. Hence, perquisites like motor car, lunch, refreshment, travelling, touring, gift, credit card, club etc. will be added to salary only in cases where employer in individual or HUF and is not liable to FBT.

Valuation of motor car -.If car is owned or hired by employer and provided for personal purposes of employees, valuation will be expenditure incurred by employer on running and maintenance plus remuneration of chauffer plus normal wear and tear @ 10% on actual cost less amount charged to employees.

If motor is partly for official and partly for personal purposes and expenses are reimbursed by employer, perquisite value per month is Rs 1,2000 per month if engine cubic capacity is upto 1.6 liters and Rs 1,600 per month if cubic capacity of engine exceeds 1.6 liters.

If motor is partly for official and partly for personal purposes and expenses are reimbursed by employer, perquisite value per month is Rs 1,200 per month if engine cubic capacity is upto 1.6 liters and Rs 1,600 per month if cubic capacity of engine exceeds 1.6 liters. If chauffer is provided, value of perquisite will be Rs 600 per month.

If motor is partly for official and partly for personal purposes and expenses are met by employee, perquisite value per month is Rs 400 per month if engine cubic capacity is upto 1.6 liters and Rs 600 per month if cubic capacity of engine exceeds 1.6 liters. If chauffer is provided, value of perquisite will be Rs 600 per month.

Other amounts paid - Club fees paid on behalf of employee, insurance premiums paid on behalf of employee, income tax paid on behalf of employee are all treated as perquisites and its cost is added to income of employee.

Gifts - Gifts upto Rs 5,000 per year are exempt.

13.3.4 ***Deductions from Salary Income*** - Following deductions are permissible from salary income -

Professional Tax paid to State Government is allowable as deduction

Entertainment allowance upto Rs 5,000 is allowable to Government employees.

13.3.5 ***Exemptions for salary income*** - Following are exempt from income tax-

Transport allowance upto Rs 800 per month granted to an employee to meet his expenditure for the purpose of commuting between place of residence and the place of his duty.

Conveyance and transport allowance granted to employee to meet cost of travel on tour are exempt. Allowance granted to meet expenditure incurred on conveyance in performance of duties of an office or employment are exempt. In *LIC Officers* v. *LIC of India* (2000) 112 Taxman 227 (Bom HC DB), it was held that conveyance allowance is exempt only if expended for meeting expenses wholly and necessarily incurred or to be incurred in performance of duties of office. Conveyance allowance at flat rate irrespective of place of residence, work and posting will *not* be exempt from income tax.

Conveyance and transport allowance granted to employee to meet cost of travel on transfer are exempt. Expenses granted to meet cost of travel on transfer and cost of packing and transportation of personal effects on such transfer are exempt.

Use of employer's vehicle or transport provided for journey of employee from residence to his place of work and back is not treated as perquisite and its cost is not treated as income.

Refreshments during office hours to employees and recreational facilities provided to group of employees are not treated as perquisites.

13.4 INCOME FROM HOUSE PROPERTY

Income from house property consists of buildings and/or lands appurtenant thereto. However, income only from vacant plot or land is treated as 'income from other sources'. Following should be noted.

In case of let out property, income will be 'fair annual value' i.e. sum reasonably expected to be received from letting or 'actual rent received' whichever is higher. Deduction is allowable for unrealized rent.

'Annual Value or Property' is the sum for which the property could reasonably be expected to let from year to year. Municipal Valuation of ratable value can be taken as one of the tests to determine *bonafide* value of the property. If the house property is given on rent, actual rent received will be the 'annual value of the house property'.

From the 'Annual Value of House Property', in case of let out property, following will be allowed as deduction – (a) Municipal tax – The deduction will be permitted on actual payment basis (b) Standard deduction of 30% of (gross annual value less municipal tax) [section 24(a) of Income Tax Act] (c) Interest on capital borrowed to acquire or construct the house property subject to limit explained below [section 24(b) of Income Tax Act]

Annual Value of a self-occupied property is taken as 'Nil', if it is not let out. In such cases, none of the aforesaid expenses are allowed as deduction. However, if the self-occupied property is acquired or constructed or repaired from borrowed funds, interest payable on such funds upto Rs 1,50,000 per annum is allowed as deduction. Interest on borrowed capital for repairs is allowable as deduction upto Rs 30,000.

Naturally, this will be a 'loss' as the annual value of self occupied property is 'Nil'. This 'loss' can be set off against any other income of the assessee. In other words, if funds are borrowed to acquire or construct or repair self-occupied property, interest upto Rs 1,50,000 / 30,000 paid per annum is allowable as deduction from any other income.

House property or any portion thereof occupied by the owner for purpose of his business or profession is excluded and any expense of current repairs, municipal taxes, depreciation on property etc. is allowable as business expenditure.

13.5 PROFITS AND GAINS OF BUSINESS OR PROFESSION

Profit and gains of business as specified in section 28 of Income tax Act are taxable.

The term 'business' includes trade, commerce or manufacture or adventure or concern in nature of trade, commerce or manufacture [section 2(13) of Income Tax Act]

'Professional Income' is income from exercise of any profession or vocation which calls for an intellectual or manual skill. It covers doctor, lawyers, accountants, consulting engineers, artists, musicians, singers etc.

Profits of business or gains from profession are calculated after allowing all legitimate business expenditure. Some important deductions admissible in computing income from business or profession are as follows [sections 30 to 36 of Income Tax Act] —

- Rent, rates, taxes, repairs and insurance for business or professional premises [section 30 of Income Tax Act]
- Current repairs and insurance of machinery, plant and furniture [section 31 of Income Tax Act]
- Depreciation on building, machinery, plant or furniture [section 32 of Income Tax Act] (discussed below)
- Revenue expenditure on scientific research [section 35(1) of Income Tax Act]
- Capital expenditure on scientific research related to business (except land) [section 35(2) of Income Tax Act]
- Preliminary expenses in relation to formation of a company or in connection with extension of an undertaking or setting up of a new industrial unit can be amortised in 5 equal installments over 5 years. The preliminary expenditure is permitted only upto 5% of cost of project [section 35D]
- Insurance expenses [section 36(1)(i) of Income Tax Act]
- Insurance premium on health of employees [section 36(1)(ib) of Income Tax Act]
- Bonus or commission to employees [section 36(1)(ii) of Income Tax Act]
- Interest on borrowed capital [section 36(1)(iii) of Income Tax Act]

- Contributions towards approved provident fund, superannuation fund and gratuity fund [section 36(1)(iv) and 36(1)(v) of Income Tax Act]
- Bad debts in respect of income considered in previous years can be written off and allowable as deduction [section 36(1)(viii) of Income Tax Act]
- Banking cash transaction tax [section 36(1)(xiii) of Income Tax Act]
- Advertisement expenditure is fully allowed as deduction. However, expenditure incurred on advertisement in any souvenir, brochure, pamphlet etc. of a political party is not allowed as a deduction [section 37(2B) of Income Tax Act]
- Expenditure in maintenance of guest house is permissible as deduction [section 36(1)(i) of Income Tax Act]
- Any other expenditure which is not of capital nature or personal expenses of the assessee is allowed if it is expended wholly and exclusively for the purposes of business or profession. However, it should not have been for purpose which is an offence or is prohibited by any law [section 37 of Income Tax Act]

13.5.1 ***Depreciation*** - Depreciation means diminution in value of an asset on account of wear and tear and obsolescence.

In any business, raw material is used fully and immediately, while plant and machinery is used slowly over a period of time. After the estimated life of machinery, its value becomes Nil. Hence, it is fair that cost of machinery is charged over the period of its estimated useful life. This is the basic principle of depreciation on capital goods. Since land does not depreciate, no depreciation is allowed on land.

Under Income Tax, depreciation is calculated on the basis of 'block of assets'. 'Block of assets' means a group of assets falling within a class of assets, in respect of which the same % of depreciation rate has been prescribed. e.g. all machinery having rate of depreciation as 25% will form one block of asset, machinery having 40% rate of depreciation will form another 'block of asset' and so on.

Depreciation is allowed on actual cost of the asset. Interest paid on borrowed funds and capitalised as pre-commencement expenses before the asset is commissioned is added to cost of the asset and depreciation claimed on such expenditure. Thus, pre-production expenditure can be included in cost of the machinery and depreciation can be charged on such 'actual cost'. In *Chellapalli Sugar* v. *CIT* AIR 1975 SC 97 = 98 ITR 167 (SC), it as held that it includes all expenditure necessary to bring such asset into existence. [Thus, it will include installation charges]. It was held that interest on loans upto date of commencement of business forms part of 'actual cost' of plant for purpose of depreciation.

Depreciation is calculated on Written Down Value (WDV) method. If the asset is put to use for purpose of business for less than 180 days, only 50% of normal depreciation is permissible. In other words, full depreciation for the year is permissible only if asset is commissioned before 30th September of that year.

If depreciation cannot be fully claimed in a particular year for want of profits, the un-absorbed depreciation can be carried forward for any number of succeeding assessment years. [section 32(2)].

The depreciation rates in respect of some important assets are as follows :

- Residential building – 5%. Others (including hotels and boarding houses) – 10%. Purely temporary structures – 100%.
- Furniture and fittings including electrical fittings – 10%
- Motor cars 15% . Buses, lorries, and taxis used in business of running them on hire – 30%,
- Pollution control equipment and specified energy saving devises - 100%
- General machinery - 15%, aeroplane – 40%, Ships – 20%
- Computers including software - 60%.
- Books by professionals – 100% for annual subscription and 60% for others - books in library - 100%.
- Intangible assets - know-how, patents, copyrights, trade marks, licenses, franchises or any other right of similar nature - 25%.

In *Mysore Minerals* v. *CIT* 1999 AIR SCW 3146 = 1999(5) SCALE 340 = 239 ITR 775 = AIR 1999 SC 3185 = 106 Taxman 166 (SC), it was held that claimant of depreciation need not be owner of asset in legal sense. Person in whom for the time being vests the dominion over the asset and who is entitled to use it in his own right is eligible to claim depreciation. – followed in *Dalmia Cement* v. *CIT* 2000 AIR SCW 4198 (SC 3 member bench).

However, if assessee has not acquired dominion over the asset, he will not be entitled to depreciation on that asset. – *Tamilnadu Civil Supplies* v. *CIT* (2001) 116 Taxman 369 = 2001 AIR SCW 4777 (SC 3 member bench).

Depreciation compulsory – As per Explanation 5 to section 32(1)(ii), inserted w.e.f. 11.5.2001, depreciation is compulsory in computing total income even if assessee had not claimed the same. This amendment applies to AY 2002-03 onwards. [In *CIT* v. *Mahendra Mills* (2000) 2 SCALE 384 = AIR 2000 SC 1960 = 243 ITR 56 = (2000) 109 Taxman 225 (SC), it was held that assessee has option to claim or not to claim depreciation. The depreciation cannot be thrust upon him. Now, this judgement is ineffective from AY 2002-03]

Depreciation in case of imported machinery obtained on loan in foreign currency – If machinery is imported on loan repayable in foreign currency, the amount payable in rupees will go on changing due to fluctuations in foreign exchange rates, as the installments and interest are spread over a period. In such case, the value of machinery should be increased on basis of entire loan outstanding and not merely installments of loans that fell due during the accounting period. – *CIT* v. *Arvind Mills* (1992) 193 ITR 255 = 60 Taxman 192 (SC) – quoted and fol-

lowed in *CIT* v. *Madras Fertilizers* (2002) 124 Taxman 581 (Mad HC DB).

13.5.2 ***Expenditure not allowed as deduction*** - Following expenditures are not allowed as deduction for purpose of income tax.

Deduction of taxes, interest etc. Only on actual payment basis - Tax, duty, cess, fees payable under any law, Employer's contribution to provident fund or ESIC, bonus to employees, commission to employees, interest on any loan or borrowing from financial institutions, banks, SFC, leave encashment are eligible as deduction only if they are paid on 'due dates' on which these were payable. Even if these are not paid on due dates but are paid before filing of return, these are allowed as deduction, if proof of payment is filed along with the return. However, in case of employer's contribution to provident fund, superannuation fund or gratuity fund, the same is allowed as deduction only if it was paid before due date of payment [section 43B of Income Tax Act]

Expenditure in excess of Rs 20,000 in cash fully disallowed - If expenditure is incurred in business or profession by payment of cash over Rs 20,000, entire expenditure is disallowed [Earlier, 20% of such expenditure was disallowed upto AY 2007-08].. All payments made to a party in a day will be considered for considering the limit of Rs 20,000 [section 40A(3) of Income Tax Act]

Payment over Rs 20,000 should be made by cheque or demand draft.

However, this restriction is not applicable in case of payments to # RBI, other banks and financial institutions, LIC # Government payments, payment by book adjustment, railway freight * Payment for agricultural produce, poultry, fish etc. to the cultivator, grower or producer (i.e. payments to middlemen are not excluded from this provision) [rule 6DD]

Similarly, a person can accept loans or deposits of Rs 20,000 or more only by account payee bank draft or cheque.

Interest on delayed payment to small industries - Interest on delayed payment made to Small Scale Industries is not allowable as deduction.

Expenditure for any purpose which is an offence in law - Section 37(1) of Income Tax Act states that any expenditure incurred for any purpose which is an offence or which is prohibited by law shall not be allowed as deduction.

13.5.3 ***Different accounting for balance sheet and income tax purposes*** - Method of depreciation, valuation of stock etc. is different under Companies Act and Income Tax Act. Hence, one method of accounting for income tax and other for Companies Act is permitted. The practice has been specifically approved in *United Commercial Bank* v. *CIT* 1999 AIR SCW 4050 = AIR 2000 SC 94 = 106 Taxman 601 (SC).

Accounting profits and assessable profits are conceptually different. – *CIT* v. *Bipinchandra Maganlal* (1961) 41 ITR 290 (SC).

13.6 OTHER IMPORTANT PROVISIONS IN RESPECT OF BUSINESS INCOME

Some important provisions in relation to income from business or profession are as follows -

Maintenance of books of account - In respect of professional in legal, medical, engineering, architecture, accountancy or technical consultancy must maintain books, if their gross receipts are less that Rs 1.50 lakhs, they have to maintain such books of account as may enable Income Tax Officer to compute their taxable Income. If their gross receipts exceed Rs 1.50 lakhs, they have to maintain books of account as specified in rule 6F i.e. cash book, journal, ledger, copies of bills exceeding Rs 25 issued by him, original bills in respect of expenditure and payment vouchers etc. Person carrying on medical profession has to maintain additional books as prescribed. [Section 44AA and rule 6F]

Persons carrying on business or professionals other than those mentioned above have to maintain books of accounts if annual income exceeds Rs 1,20,000 or gross receipts or turnover exceed Rs. ten lakhs in case of business also have to maintain books of account.

Accounts on mercantile or cash basis - Accounts should be maintained either on mercantile basis or cash basis. Hybrid i.e. mixed system is not permitted. [In cash system, income or expenditure is considered only when it is actually received / paid. In mercantile system, income / expenditure is considered on accrual and payable basis. Actual receipt or payment may occur in subsequent financial year and may not happen in that particular year.]

Income tax audit report - If gross receipts or turnover of business exceeds Rs 40 lakhs per annum, the accounts have to be compulsorily audited. In case of professional income, accounts have to be audited if gross receipts exceed Rs ten lakhs. This audit report should be submitted along with income tax return. [section 44AB].

13.7 CAPITAL GAINS

Capital gains means any profit or gains arising from transfer of a capital asset. Such capital asset may be building, non-agricultural land, machinery, shares, jewellery etc. However, stock in trade, agricultural land in rural area and personal effects (other than jewellery) are not 'capital assets'.

From AY 2008-09, archaeological collections, paintings, sculptures will not be treated as 'capital assets'.

Broadly, 'capital gain' is the difference between the price at which the asset was acquired and the price at which the same asset was sold. In technical terms, capital gain is the difference between cost of acquisition and the full value of consideration. Incidental expenditure and cost of improvement is allowable as deduction.

The 'cost of acquisition of capital asset' is to be increased by Cost Inflation Index. The index is announced by Central Government every year. The index was 100 for 1981-82, 172 for 1989-90, 244 for 1993-94, 331 for 1997-98, 351 for 1998-99, 389 for 1999-2000, 406 for 2000-01, 426 for 2001-

02, 447 for 2002-03, 463 for 2003-04 and 480 for 2004-05, 519 for 2006-07 and 551 for 2007-08.

The cost of acquisition will be adjusted on basis of the above index and then capital gain will be calculated. The formula is Cost of acquisition x Cost Inflation Index of the year in which the asset is transferred / Cost Inflation Index of the year of acquisition. If the asset was acquired before 1.4.1981, the Cost Inflation Index of that year will be treated as 100. Thus, if an asset was brought in 1989-90 for Rs one lakh and sold in 1997-98 for Rs three lakhs, the adjusted cost of acquisition will be (1,00,000 x 331)/172 i.e. Rs 1,92,442, and capital gains will be Rs 1,07,558 (3,00,000 - 1,92,442). *Such adjustment is permissible only for long term capital gains and not for short term capital gains.*

Expenditure incurred on any improvement in asset is permitted as deduction and that cost can also be adjusted on the same principles as above.

If a company issues bonus shares, the cost of acquisition of bonus shares will be treated as 'Nil'. Thus, if the bonus shares are sold, net sale proceeds of bonus shares will be liable to capital gains.

Expenditure incurred in connection with transfer (like stamp duty, registration charges, legal fees, brokerage etc.) are allowed as deduction. Capital gain is charged as income of the financial year in which the transfer took place.

Capital gain can be classified as 'short term' or 'long term'. A short term capital gain is when the asset was held by the assessee for a period of upto 36 months. If the asset was held for more than 36 months, the gain will be long term gain. The period is only 12 months (instead of 36 months) in case of shares or any other security listed in stock exchange or units of UTI or units of mutual fund.

The income tax rate is 20% on long term capital gains, while calculating the long term capital gains, indexation of purchase price is required. *Tax on long term capital gain shall be subject to ceiling of 10% of capital gains calculated without indexing.*

The short term gains are added in other income of the assessee and the income tax is payable according to the normal rate applicable to the assessee.

Capital gains arising from sale of residential house is exempt if the original asset (i.e. the house) was held for more than three years and a new house was purchased within one year before or two years after the sale of original asset, or a new residential house is constructed within three years. The cost of new asset (residential house) should be more than the amount of capital gains [section 54 of Income Tax Act]

Any other long term capital gain is exempt if the capital gains are invested within 6 months in 3 year bonds issued by REC or NHAI and that investment is retained for three years. Investment cannot exceed Rs 50 lakhs - section 54EC of Income Tax Act.

13.8 INCOME FROM OTHER SOURCES

All income other than income from salary, house property, business and profession or capital gains is covered under 'Income from other sources'. Provisions in respect of some important sources of 'other income' are summarised below.

Dividends - Dividends on shares of domestic companies or units of UTI or mutual fund received from a company on or after 1-4-2003 will not be taxable at the hands of the assessee [section 10(34) and 10(35)]. [The dividend distribution tax will be payable by company / mutual fund u / s 115-O] However, deemed dividend as defined in section 2(22) of Income Tax Act will be considered as 'income from other sources'.

Winning from lotteries, races etc. - Winning from lotteries, card games, horse races are taxable as other income. This is taxable @ 30.3% without claiming any allowance or expenditure.

Interest on securities, bank deposits and loans - Interest on bank deposits and loans is treated as 'other income', if not taxable u / s 28.

Gifts - Gifts in a year exceeding Rs 50,000, except gifts from certain relatives and gifts on certain specified occasions will be taxable [section 56(2)(vi) of Income Tax Act]

Income from letting - Income from letting of furniture, machinery, plant and building which is not separable fro, composite letting with machineries is taxable as other income. Current repairs, insurance and depreciation are allowed as deductions [section 56(2)(ii) and (iii) of Income Tax Act]

13.9 REBATE / EXEMPTION FROM INCOME TAX LIABILITY

Following rebates / exemptions are available.

13.9.1 *Deductions under chapter VI-A and rebates*

Investments and deposits - Investments in PPF, Provident Fund, LIC, repayment of housing loans, NSIC, 5 year FDR with scheduled banks etc. are allowed as deduction upto Rs 1,00,000 u / s 80C.

Deduction of medical insurance premium, pension fund - Following deductions are permissible - (a) Medical insurance premium upto Rs 20,000 for senior citizen and Rs 15,000 for others (section 80D). (b) Contribution to pension fund within overall ceiling of Rs one lakh (section 80CCC)

Donations - Contribution to approved charitable institutions - in some cases 50% of amount paid is allowed as deduction, while in some cases, 100% amount paid is allowed as deduction (section 80G).

Exemption to EOU, SEZ - Income In case of EOU, STP, EHTP and BTP, the concession will continue upto 31-3-2010. In case of SEZ, exemption is for larger period.

13.10 OTHER PROVISIONS OF INCOME TAX

Certain other important provisions of income tax are discussed here.

13.10.1 ***Clubbing of Income*** - Often salary or other expenses from business are shown in name of close relatives like spouse (wife / husband) or minor child, to reduce tax liability. In such case, if the individual has a substantial interest in the concern, the income of such wife, husband or minor child will be added to the income of such individual. This is termed as 'clubbing of income'.

The clubbing provision is not applicable if spouse possesses technical or professional qualifications and the income is solely due to application of his / her technical knowledge and experience [section 64(1)(ii) of Income Tax Act]

If an asset is transferred to the spouse, income from such asset is also treated as income of the individual. [e.g. by transferring shares, house property etc.].

Similarly, if an individual throws his separate property into the property of HUF, income from such converted property will be included in the total income of such individual [section 64(2) of Income Tax Act]

The clubbing provision has obviously been made to plug avoidance of income tax liability, by 'showing' some income in the name of spouse / minor child / HUF.

13.10.2 ***Set off and carry forward of loss***

Carry forward of loss other than speculation loss - Carry forward of loss is permitted only when return is filed in time. In case of closely held company, unabsorbed loss can be carried forward only if at least 51% of shares are held beneficially by same persons who were holding them in previous year.

Unabsorbed depreciation - Unabsorbed depreciation can be set ff against any head of income other than salary. It can be carried forward to any number of years. It can be carried forward by same assessee except in case of amalgamation, demerger and business reorganization.

Speculative loss - Loss from speculative transactions involves sale and purchase of commodities including stocks and shares. It can be set off against speculative profits only and can be carried forward for four years.

13.10.3 ***Permanent Account Number*** - Every person whose total sales, turnover or gross receipts are over Rs 5,00,000 are required to apply and obtain a Permanent Account Number (PAN) [section 139A]. In addition, ITO can allot PAN *suo moto* to a person by whom income tax is payable.

Government has decided to use PAN as a common business identification number to be used by various agencies and departments like customs, excise, DGFT etc.

13.10.4 ***Advance Income Tax*** **-** Tax is deducted from salary payable to an employee. Since a businessman or professional earns his own income, there is no TDS (Tax Deduction at Source). Hence, he is liable to pay advance tax as he earns income. This is 'Pay Tax as you Earn'. Thus, advance tax is payable on the basis of estimated income of the current financial year. [The income is 'estimated' because, actual income will be known only after the financial year is over].

Advance tax is payable only in cases where tax payable is in excess of Rs 5,000. The assessee has to pay advance tax on his own accord and no notice will be issued to him. The advance tax is payable in installments as follows -

In case of company - # 15% on or before 15th June # 30% on or before 15th September # 30% on or before 15th December # Remaining 25% on or before 15th March. If there was shortfall in earlier installment, it should be made up in subsequent installment.

* ***In case of partnership firms, proprietors, professionals etc***. - # 30% on or before 15th September # 30% on or before 15th December # Remaining 40% on or before 15th March. If there was shortfall in earlier installment, it should be made up in subsequent installment.

Thus, 100% income tax in respect of estimated income of current financial year is payable by 15th March. If any instalment is not paid on due date, it can be paid subsequently.

If advance tax is not paid or short paid on due dates, mandatory interest is payable as follows :

- If advance tax was not paid before 31st March of the financial year, or advance tax paid was less than 90% of the assessed tax, interest @ 1% per month or part thereof is payable from 1st April till the month of payment. [section 234B]. The interest is not payable if total tax liability is less than Rs 5,000 or if at least 90% of assessed tax was paid before 31st March.

- If installments of advance tax are not paid on due dates, interest on shortfall is payable @ 1% per month. In case of last instalment which is due on 15th March, interest @ 1% is payable for one month if tax is not paid at all or is paid after 15th March. [section 234C]. Note that this interest is calculated only upto 31st March, as from 1st April, interest @ 1% becomes payable on entire tax due under section 234B.

This interest is mandatory and there is no provision to grant exemption form payment of this interest.

If the return is not filed within due date, interest @ 1% is payable u / s 234B. In addition, interest @ 1% is payable u / s 234A. Thus, if return is not filed on or before due date, interest payable is 2% for every subsequent month.

13.10.5 ***Special provisions in respect of Partnership firm*** - A partnership firm is presently assessed on the lines similar to the assessment of a company. The firm can pay salary and interest on capital to the partners. Income tax is payable on profits calculated after deducting salary and interest paid to partners. The salary paid to partners is treated as 'business income' in their hands and is taxable accordingly.

The partnership firm may or may not be registered. However, the partnership must be evidenced by a partnership deed. The deed should indicate * individual shares of the partners * Salary payable to working partners * Interest payable to partners. A true copy of partnership deed certified and signed by all the partners should be filed along with the first return of income. Subsequently, the copy is not required to be filed along with every return. However, if there is any change in the partnership agreement, a fresh copy has to be filed.

Return of partnership firm can be signed by managing partner.

Salary to working partners - The salary payable to partners is as follows -

* Professional partnership firms - # upto book profit of Rs 1,00,000 - 90% of book profit - minimum Rs 50,000 # On next Rs 1,00,000 book profit - 60% # On balance of book-profit - 40%.

* Other than professional partnership firms (i.e. business firms) - # upto book profit of Rs 75,000 - 90% of book profit - minimum Rs 50,000 # On next Rs 75,000 book profit - 60% # On balance of book-profit - 40%.

The salary can be paid only to working partners. Such payment should be authorised by partnership deed. This salary is allowed as deduction from income of the partnership firm and is taken as business income of the individual partner.

Interest to partners - Income Tax Act provides that interest upto 12% paid to the partners will be allowable as deduction from income of partnership firm [section 40(b)((iv) of Income Tax Act]. [The interest rate was 12% upto 31-5-2002]. Such payment should be authorised by partnership deed. This interest is allowed as deduction from income of the partnership firm and is taken as 'other income' of the individual partner.

13.10.6 *Tax deduction at source (TDS)*

A person is under liability to deduct income tax at source and pay it to Government. He should issue a certificate to the person from whom tax is deducted, so that the person can submit the same to Income Tax authorities. Tax deducted at source should be paid to Government within one week from date of deduction. At the end of the year, a return in prescribed form has to be filed with ITO.

TDS is rightly called 'tedious', but not deducting tax at source can invite penalties.

As can be seen from following, if the person making payment is individual or HUF, he is exempt from the provisions of TDS in most of the cases, if he is not required to submit income tax audit report u/s 44AB. However, TDS provisions apply to (a) salary payments made by an individual or HUF even if he is not required to submit any income tax audit report u/s 44AB (b) If the individual/HUF is required to submit Income Tax Audit report.

TDS from salary - Every employer has to deduct tax from salary of employees. Payer should calculate tax payable on salary at the [section 192].

While deducting tax at source, the employer can consider the investments made by employee which qualify for exemption, payment for purchase or construction of house, mediclaim insur-

ance premium etc. Income tax is to be deducted every month and should be paid to Government within a week after deduction. The employer can adjust deductions from month to month so that total deductions from salary of the whole year is equal to tax payable by employee on salary income.

Deduction under section 80G is not to be considered by employer (except some specified funds like PM Relief Fund etc.) while calculating tax liability of employee. The tax relief has to be claimed by employee through tax return.

The employer has to file an annual return of tax deducted at source from all employees.

TDS from Interest other than interest on securities - Tax should be deducted from interest paid if interest payable in financial year exceeds Rs 10,000 in case of banks, post office and cooperative society and Rs 5,000 in case of others [section 194A].

If recipient is a resident other than domestic company, TDS is as follows - (a) If recipient is individual / HUF / AOP where aggregate payment or credit is upto Rs 10 lakhs, cooperative society, local authority, firm where aggregate payment or credit does not exceed Rs one crore - 10.3% (b) If recipient is individual / HUF / AOP where aggregate payment or credit exceeds Rs 10 lakhs, firm where aggregate payment or credit exceeds Rs one crore - 11.33%

If recipient is a domestic company, TDS rate is as follows - (a) If recipient is domestic company where aggregate payment or credit does not exceed Rs one crore - 20.6% (b) If recipient is domestic company where aggregate payment exceeds Rs one crore - 22.66%

An individual who is 65 years of age or above can get interest without deduction of tax at source, if he submits a self-declaration to the payer in duplicate, in form No. 15H. Others have to submit declaration in form 15G.

The payer has to submit one copy of declaration (form 15G / 15H as applicable) to Commissioner of Income Tax under whose jurisdiction his tax is being assessed.

Individuals and HUF are required to deduct tax on interest payment, if they is required to submit income tax audit report u / s 44AB. Provisions of making payment of TDS do not apply to small HUF and individuals who do not have to submit income tax audit report.

TDS from Payments to contractors, sub-contractors and advertising contracts - TDS provisions apply if contract value exceeds Rs 20,000 for single payment or Rs 50,000 in aggregate for a financial year [section 194C].

In case of contract other than advertising contract, TDS is at following rates - (a) If recipient is individual / HUF / AOP where aggregate payment or credit is upto Rs 10 lakhs, cooperative society, local authority , firm / domestic company where aggregate payment or credit does not exceed Rs one crore - 1.03% (b) If recipient is individual / HUF / AOP where aggregate payment or credit exceeds Rs 10 lakhs, firm / domestic company where aggregate payment exceeds Rs one crore - 1.133%

In case of advertising contract, TDS is at following rates - (a) If recipient is individual / HUF / AOP where aggregate payment or credit is upto Rs 10 lakhs, cooperative society, local author-

ity , firm / domestic company where aggregate payment or credit does not exceed Rs one crore - 2.06% (b) If recipient is individual / HUF / AOP where aggregate payment or credit exceeds Rs 10 lakhs, firm / domestic company where aggregate payment exceeds Rs one crore - 2.266%

TDS is also required to be deducted, if payment to contractors / sub-contractors is made by an individual or HUF, who is required to submit income tax audit report u / s 44AB. Provisions of making payment of TDS do not apply to small HUF and individuals who do not have to submit income tax audit report.

TDS from payment on advertising contracts - See above. Provision of TDS applies when client makes payment to advertising agency and not when advertising agency makes payment to the media i.e. print media or elecronic media.

TDS from commission / brokerage – TDS applies in respect of payment of commission or brokerage to resident. There is no TDS if commission / brokerage paid during the financial year is less than Rs 2,500. [section 194H]

TDS is at following rates - (a) If recipient is individual / HUF / AOP where aggregate payment or credit is upto Rs 10 lakhs, cooperative society, local authority , firm / domestic company where aggregate payment or credit does not exceed Rs one crore - 10.3% (b) If recipient is individual / HUF / AOP where aggregate payment or credit exceeds Rs 10 lakhs, firm / domestic company where aggregate payment exceeds Rs one crore - 11.33%

TDS provisions are applicable, if payment of commission / brokerage is made by an individual or HUF, who is required to submit income tax audit report u / s 44AB. Provisions of making TDS payment do not apply to small HUF and individuals who do not have to submit income tax audit report.

TDS from Payments of Rent - TDS provisions apply if aggregate sum of rent paid exceeds Rs 1,20,000 per annum [section 194-I]

The TDS rates vary between 10.3% to 22.66% depending on whether rent is for plant, machinery, land, furniture etc. and who is the recipient.

TDS provisions are applicable, if payment of rent is made by an individual or HUF, who is required to submit income tax audit report u / s 44AB. Provisions of making payment of TDS do not apply to small HUF and individuals who do not have to submit income tax audit report.

TDS from Payments for professional or technical services - TDS provisions apply if aggregate sum paid for professional or technical services exceed Rs 20,000 per annum [section 194J]. TDS should be on total payment including reimbursement of expenses, as per CCBDT circular No. 715 dated 8-8-1995. However, I ITO v. Dr. Willmar Schwabe (2005) 3 SOT 71 (ITAT), it has been held that reimbursement of expenses for which bill is separately raised did not attract the provisions of section 194J.

TDS is at following rates - (a) If recipient is individual / HUF / AOP where aggregate payment or credit is upto Rs 10 lakhs, cooperative society, local authority , firm / domestic company where aggregate payment or credit does not exceed Rs one crore - 10.3% (b) If recipient is individual / HUF / AOP where aggregate payment or credit exceeds Rs 10 lakhs, firm / domes-

tic company where aggregate payment exceeds Rs one crore - 11.33%

TDS provisions are applicable, if payment for professional or technical services is made by an individual or HUF, who is required to submit income tax audit report u/s 44AB. Provisions of making TDS payment do not apply to small HUF and individuals who do not have to submit income tax audit report.

TAN number – Assessee should obtain TAN (Tax Deduction Account Number) which is required to be quoted on all TDS returns. It is a 10 digit alphanumeric code.

TDS Return – Person who has deducted tax at source is required to file return to Income Tax department on annual basis. In case of companies, the return is to be filed on computer media, i.e. for them, filing of e-TDS is compulsory. The form has been prescribed. 'Electronic Filing of Returns of Tax Deducted at Source Scheme, 2003' has been notified by CBDT for this purpose. The return has to be filed in prescribed form in floppy. NSDL (National Securities Depository Ltd.) has been given task of handling e-TDS returns.

13.10-7 ***No income tax clearance certificate*** – Income Tax department has discontinued giving Income Tax Clearance Certificates for various purposes like filing tender, bidding contracts etc. No such certificate will be issued by Income Tax department. The contractors etc. should quote PAN – CBDT circular No. 2/2004 dated 10-2-2004.

13.11 INCOME TAX RETURNS

Every assessee should file an annual return in prescribed form. The prescribed forms are as follows -

Form No.	Applicable to	Details
ITR 1	Individuals	Salary (including pension and family pension) and interest
ITR 2	Individuals and HUF	Any income other than business income
ITR 3	Individuals and HUF	Who are partners in firm but not carrying on business or profession as proprietor
ITR 4	Individuals and HUF -	Who are proprietors having income from business or profession
ITR 5	Firm, AOP, BOI	Including return of FBT
ITR 6	Companies except charitable companies claiming exemption u/s 11	Including return of FBT
ITR 7	Charitable trusts etc. including cases covered by section 139(4A) to 129(4D)	Including return of FBT
ITR 8	Persons liable to FBT	FBT return only
ITR-V	All except charitable trusts who have filed return electronically without digital signature	Verification form for persons who have filed return electronically but without digital signature

The income tax return is really a self assessment memorandum. The assessee should calculate the tax and interest payable by him and pay it by challan. The payment will of course be after deducting the advance tax which he might have already paid.

E-return – Beginning has been made in 2003 for electronic filing of return under Electronic Furnishing of returns of Income Scheme, 2003. Filing of e-return is compulsory for corporate employees.

Due dates for filing return - The due dates for filing return are as follows -

* (a) Individuals having only salary income (b) Non-corporate assessees (Individuals, HUF, partnership firms or societies) having income from business or profession but who do not have to get their accounts audited under Income Tax or any other law - 31st July

* (a) Non corporate assessees (Individuals, HUF, partnership firms or societies) having income from business or profession and who have to get their accounts audited (b) A working partner where the firm in which he is a working partner has to get its accounts audited (c) Corporate Assessee (d) Persons who have to file return under one by six scheme – 30th September (Till 2007, it was 31st October).

The dates are mandatory and there is no provision to extend the due date. If the return is filed beyond due date, mandatory interest @ 1% per month of tax due is payable. Belated return upto one year beyond due date is permissible. Mandatory interest is payable, but no penalty is payable. Thus, if no tax was due, belated return upto one year can be submitted without payment of any interest.

A loss return must be filed in time. Otherwise, the carry forward of loss is not permitted. However, CBDT can grant extension for submitting return by a loss making company.

Signature on return - The return should be signed by individual, karta of HUF, managing partner, managing director etc. In some cases, return can be signed by authorised representative.

No intimation will be sent by Income Tax Officer, if any tax / interest / refund is not due on the basis of return of income / wealth filed.

Scrutiny of returns - Some of the returns are taken by ITO for detailed scrutiny. Notice for scrutiny has to be served within 12 months from end of the month on which return is furnished. The ITO can require assessee to attend his office or produce evidence in support of the return filed.

Payment of tax - The advance tax and self-assessment tax should be paid vide prescribed challan.

STUDY NOTE -14

INCOME TAX - SOME ISSUES

This Study Note includes

- Merger and Amalgamation
- Demerger
- Slump Sale
- Cost of Acquisition at the hands of Shareholder after demerger
- Expenditure in respect of Amalgamation
- Amalgamation / Merger and Indirect Taxes
- Income Tax Exemptions to developer and SEZ Unit
- Transfer Pricing
- Practical Examples

14.1 MERGER AND AMALGAMATION

Business Reorganisation has been made tax neutral under Income Tax Act. It has been recognised that business organisation can be by way of amalgamation, de-merger or slump sale. Provisions have been made for each type of reorganisation. Effect of reorganisation on shareholder of the companies has also been clarified. These changes are summarised here.

Amalgamation takes effect on the date mentioned in the scheme, even if sanction of Court is obtained later.

Amalgamation and Income Tax - Section 2(1B) of Income Tax Act defines 'amalgamation' as merger of one or more companies with another company or merger of two or more companies to from one company in such a manner that all property and liabilities of amalgamating company or companies become property of amalgamated company At least 90% share holders of amalgamating company should become members of amalgamated company. 'Amalgamating company' means company which is merging and 'amalgamated company' means the company with which it merges or the company which is formed after merger. However, acquisition of property of one company by another is not 'amalgamation'.

The amalgamation is not considered as transfer and hence there is no liability of capital gains tax, if amalgamated company is Indian company. [section 47(vi) of Income Tax Act]. Transfer of assets by one company to another in scheme of amalgamation is not regarded as distribution of profits within the meaning of section 2(22)(a) of Income Tax Act. Amalgamation involves merger and not liquidation and hence section 2(22)(c) of Income Tax Act is also excluded.

After amalgamation, profits of amalgamating company and amalgamated company are of course, calculated together. As per proviso to section 32 of Income Tax Act, total depreciation allowable to amalgamating company and the amalgamated company cannot exceed the normal depreciation allowable under the Act if the amalgamation had not taken place.

In respect of unabsorbed losses (accumulated losses) of amalgamating company, these are permitted to be carried forward in hands of amalgamated company only if conditions of section 72A of Income Tax Act are prescribed.

Expenditure for obtaining technical know-how, expenditure on license to operate telecommunication services or expenditure on prospecting is tax deductible in hands of the amalgamated company. [section 35AB(3), 35ABB(7) and 35E(7A) of Income Tax Act].

Expenditure incurred on amalgamation is deductible in five years in equal instalments @ 20% per year. [section 35DD(1) of Income Tax Act].

14.1.1 Amalgamation of sick company

Amalgamation is often resorted to take over a sick company. The amalgamating company may be a sick company and may have accumulated losses. Such accumulated losses are allowed to be carried forward in the hands of amalgamated company (i.e. the company in which the sick company is amalgamated), subject to following conditions - (a) The provision applies only to 'industrial undertaking or a ship'. 'Industrial undertaking' is one engaged in manufacturing or processing of goods, or manufacture of computer software or business of generation or distribution of power or mining or construction of ships, aircrafts or rail system. Thus, it does not apply to non-manufacturing sector like trading, telecom, service sector, finance and investment companies or dotcom companies (b) Minimum 75% of book value of fixed assets of amalgamated company should be retained by the amalgamated company for at least five years. (c) Amalgamated company should carry on business of amalgamating company for at least five years. (d) It should make efforts to ensure revival of the business of amalgamating company, as per conditions prescribed in rule 9C. [section 72A of Income Tax Act]. After five years, the business of amalgamating company need not be carried by amalgamated company.

As per rule 9C of IT Act, the amalgamated company shall achieve level of production of at least 50% of the installed capacity of the undertaking which was amalgamated (i.e. of amalgamating company) within 4 years from date of amalgamation and continue to maintain the minimum level till end of 5 years from date of amalgamation. A CA certificate regarding production should be submitted along with return of income. If the production level is not achieved, the amalgamated company has to apply to Central Government to relax the condition regarding achieving 50% production capacity. Government may relax the condition having regard to genuine efforts made to attain the production level and circumstances why required production level could not be achieved.

Since provisions of SICA override provisions of other Acts, amalgamation in case of sick company can be ordered by BIFR, without intervention of Court.

Aspect of stamp duty and sales tax - Amalgamation will attract stamp duty, if State law so provides. However, there is no 'sale' and sales tax should not be attracted. In *Castrol India Ltd.* v. *State of Tamilnadu* (1999) 114 STC 468 (Mad), it was held that stock transfer between transferor company and the transferee company in amalgamation from transfer date cannot be considered as a sale and therefore cannot be subjected to sales tax.

14.2 DE-MERGER

In de-merger, a unit or division of a company is transferred to another company. In slump sale (also called as hive off or spinning off), one unit / division is sold to a buyer as a going concern with assets and liabilities.

An amalgamation has reference to company as a whole whereas a de-merger has reference to an undertaking of the company. The amalgamating company will lose its identity in amalgamation whereas the de-merged company may continue to exist after de-merger.

In 'De-merger', a company transfers one or more of its undertakings, unit, division or business activity to another company, called 'resultant company'. The transfer is of assets and liabilities pertaining to that undertaking at book value, as a going concern. The resulting company issues shares to shareholders of de-merging company on a proportionate basis. [section 2(19AA) of Income Tax Act]. The company which is transferring its undertaking, unit, business activity or division is termed as 'de-merged company'. [section 2(19AAA) of Income Tax Act]

De-mergers are tax neutral and do not attract any additional liability to tax. There has to be transfer of business as a going concern and not only of specific assets. This is because, if only specific assets are transferred, it is a sale of assets and not a business reorganisation. After de-merger, the accumulated losses and unabsorbed depreciation is allowed to be carried forward in resulting company, if there are directly relatable to undertaking proposed to be transferred. When it is not possible to relate the accumulated losses to the undertaking being de-merged, the accumulated losses and depreciation will be apportioned between the de-merged company and the resulting company, in proportion of assets coming to share of each as a result of de-merger. [section 72A(4) of Income Tax Act]

When assets are transferred, WDV of block of assets of demerged company shall be reduced by WDV of assets transferred to the resulting company pursuant to the demerger. Correspondingly, assets of the resultant company will be the WDV of the transferred assets as appearing in books of account of the demerged company immediately before de-merger. - Explanations 2A and 2B to section 43(6) of Income Tax Act, added w.e.f. 1-4-2000, i.e. AY 200-2001 onwards.

If the company is de-merged, aggregate depreciation for current year will be apportioned between two entities i.e. de-merged company and resulting company in the ratio of number of days for which assets were used by them. [fourth proviso to section 32(1)(ii)]. Transfer of patent right and copyrights also has been made tax neutral [section 35A(7) of Income Tax Act].

Expenditure for obtaining know how, expenditure on license to operate telecommunication services or expenditure on prospecting of certain minerals is tax deductible in hands of the resulting company. [section 35AB(3), 35ABB(7) and 35E(7A) of Income Tax Act].

There is no capital gain at the hands of de-merged company, if the resulting company is an Indian Company. [section 47(vib) of Income Tax Act]. Any transfer in de-merger of shares held in Indian company by de-merged foreign company to resultant foreign company is also exempt, subject to certain conditions. [section 47(vic)].

Expenditure incurred on de-merger is deductible in five years in equal installments @ 20% per year. [section 35DD(1) of Income Tax Act].

One lacuna in present provision of de-merger is that it pre-supposes that only a company with positive net worth can spin off its undertaking. The undertaking proposed to be spin off should also have positive net worth, as both asset and liability of an undertaking has to be transferred and shares have to be issued to existing shareholders. Thus, a loss making unit cannot be spun off under the present provisions.

Aspect of stamp duty and sales tax - De-merger should attract stamp duty, if State law so provides. However, there is no 'sale' and sales tax should not be attracted.

14.3 SLUMP SALE

'Slump sale' is a sale where an undertaking, unit or division or a business activity is transferred from one person to another for a lumpsum consideration without values being assigned to the individual assets and liabilities transferred. One of division or undertaking as a whole is sold. [section 2(42C) of Income Tax Act].

To constitute a slump sale, it is necessary that the sale is for a lump sum consideration and no values are assigned to the individual assets and liabilities, whereas, in demerger, the resulting company issues, in consideration of de-merger, its shares to the shareholders of the demerged company on a proportionate basis. In case of amalgamation, the properties and liabilities of the amalgamating company / de-merged company are transferred at the values appearing in the books of account immediately before the merger / de-merger to the amalgamated company / resulting company.

Slump sale provisions really apply to all assessees and are not limited to companies, while provisions of amalgamation apply only to a company.

In such a sale, the gains arising from such sales will be taxed under the head 'capital gains'. The 'capital gain' will be 'long term capital gain' if the capital assets were originally held for more than 36 month. It will be 'short term capital gain', if the asset was originally held for less than 36 months. It will be deemed as income in the year in which transfer took place.

For calculating cost of acquisition of the undertaking or division transferred, 'net worth' of the undertaking or division being transferred shall be deemed as 'cost of acquisition and cost of improvement'. 'Net worth' means aggregate value of total assets of the undertaking as reduced by the value of liabilities of the undertaking or division as appearing in books of account. Any change in value of assets due to re-valuation of assets will be ignored. The 'total assets' will be Written Down Value (WDV) of block of assets. A Chartered Accountant's certificate regarding 'net worth' of transferred undertaking or division will have to be submitted to ITO. [section 50B of Income tax Act].

Aspect of stamp duty and sales tax - Hive off or spinning off or slump sale should attract stamp duty, if State law so provides. However, in the sale of an undertaking as a going concern for a lumpsum price, there is no 'sale' and sales tax should not be attracted. In *Coromandal*

Fertilizers Ltd. v. *State of AP* (1999) 112 STC 1 (AP HC FB), it was held that such a sale at the end of entire business is not 'in the course of business'. Going out of business is not a step incidental to or connected with manufacturing or business activity. Selling business is not a 'business' and hence the person is not a 'dealer'.

Agreement for hive off / slump sale - Agreement for hive off / slump sale should cover following aspects -

- Assignment of business and consideration to be paid
- Further assurances in respect of other documentation, assets, liabilities etc
- Representations and warranties to be given by seller with regard to authority to sanction sale, validity of assignment, employees terms and conditions, labour matters, status of tax and other liabilities etc.
- Representation and warranties given by buyer regarding authority to sanction buying, validity of assignment etc.
- Assignment of trade marks, patents
- Indemnity clause.
- Provisions in respect of amendments to agreement
- Arbitration clause.

14.4 COST OF ACQUISITION AT THE HANDS OF SHAREHOLDER AFTER DE-MERGER

A shareholder of de-merged company gets some shares of resulting company (i.e. new company to which some part of business is transferred) after de-merger. Such transfer is not treated as dividend distributed by the de-merged company. [section 2(22)(v) of Income Tax Act]. Issue of shares of resulting company to shareholders of de-merged company will not attract any capital gains. [section 47(vid) of Income Tax Act].

The shareholder will have shares of the original i.e. company which has de-merged. If he sales such shares, capital gain may arise. In such cases, the cost of acquisition of original shares will be bifurcated between the resulting company and the original (de-merged) company in proportion to net book value of assets transferred in de-merger to the net worth of original company before de-merger. [sections 49(2C) and 45(2D) of Income Tax Act]. e.g. assume that net worth of original i.e. de-merged company was Rs one hundred lakhs and net book value of assets transferred to resulting company was Rs 25 lakhs. If the cost of acquisition of original shares at the hands of shareholder was Rs 1,000, cost of acquisition of resulting company will be Rs 250 and cost of acquisition of original shares will be Rs 750. Thus, total cost of acquisition of original shares is bifurcated between resulting company and original company in ratio of book value of assets transferred to the net worth of original company.

If the shareholder sales the shares of resulting company, the period for which original shares were held will also be considered to determine whether the gain is a short term gain or a long term gain. [section 2(42A)(g) of Income Tax Act].

In *CIT* v. *Grace Collis* (2001) 3 SCC 430 = 2001 AIR SCW 1008 = 248 ITR 323 = 115 Taxman 326 (SC 3 member bench), it was held that in amalgamation, rights of shareholders of the transferor company in that company get extinguished upon amalgamation. Therefore, there is a 'transfer' of shares by member of their shares in amalgamating company (i.e. the company which is being amalgamated). Consequently, cost of acquisition of shares of amalgamated company is deemed to be the cost of acquisition of their shares in amalgamating company. It has to be determined as per (*earlier*) section 49(2). If member sales shares in amalgamated company, capital gains will arise.

14.5 EXPENDITURE IN RESPECT OF AMALGAMATION

In *CIT* v. *Akme Electronics* (2004) 137 Taxman 263 (Guj HC DB), it was held that legal expenses incurred by transferor company in respect of its amalgamation with another company is allowable as revenue expenditure. Amalgamation is resorted to for smooth and efficient conduct of business of company. Hence, the legal expenditure is for purpose of business of assessee even if later its business will come to an end.

In *CIT* v. *Bombay Dyeing & Mfg Co. Ltd.* (1996) 219 ITR 521 = 85 Taxman 396 (SC), it was held that expenditure incurred in connection with amalgamation is revenue expenditure.

14.6 AMALGAMATION/MERGER AND INDIRECT TAXES

Various factors are required to be considered when a company is being merged / amalgamated with another company. Points to be kept in mind by the amalgamating company are as follows -

General points applicable to all taxes – (1) Inform all tax authorities as soon as scheme is approved by members. This is only advance information and only a precautionary step. (2) Inform tax authorities with copy of High Order approving amalgamation. (3) Wherever show cause notices, adjudication, assessments or appeals are pending with Adjudicating authority or appellate Authority, submit application for change of name of assessee / appellant / respondent as the case may be. (4) Wherever registration has been obtained (e.g. under Central Excise, Sales Tax, Service Tax etc.), apply for amendment to registration certificates. Submit fresh list of directors. Inform new authorised signatories, if there is any change. (4) Detailed stock taking should be done on 'transfer date' as specified in scheme of amalgamation. Preferably, this date should be close of accounting year. This will be useful for assessments, preparing final accounts etc.

Income Tax – (1) Though there is no provision for cancellation of Permanent Account Number (PAN), Income tax Officer (ITO) should be informed that identity of old company is extinguished and old PAN is no more valid. (2) Income Tax Officer should also be informed that from the 'appointed date', the amalgamating company ceases to exist and no income tax return will be filed for subsequent period . (3) The amalgamating company, i.e. 'X' company will henceforth use the PAN of amalgamated company i.e. of 'Y'.

Central Excise - The following actions will be required – (1) When approval of High Court is obtained, application should be made to Assistant / Deputy Commissioner of Central Excise in charge of the division, for amending the Registration certificate. Fresh details should be given in prescribed form A-1. (2) If the bonds are executed, these should be got amended with new name or new bonds should be executed and old bonds should be got cancelled. (3) If LUT (Letter of Undertaking) was submitted for clearance of goods without payment of duty, fresh LUT for export may be submitted. (4) As per Rule 8 of Cenvat Credit Rules, if a factory is transferred on account of amalgamation, the manufacturer can transfer unutilised Cenvat credit to the amalgamated factory. The transfer of credit is subject to following conditions - * There should be specific provision for transfer of liabilities of such factory * The transfer is allowed only if stock of inputs as such or in process, or the capital goods are also transferred along with the factory to the new ownership and the inputs or capital goods on which credit has been availed of are duly accounted for to the satisfaction of Commissioner. Thus, transfer is possible only with permission of Commissioner of CE. In most of the cases, permission of High Court is obtained much later than the 'effective date' as specified in the scheme. However, till the permission of High Court is obtained, the two units work independently. Hence, approval of Commissioner can be obtained only as on date of application to him and not 'effective date' as mentioned in the scheme. Application giving all details of stock, Cenvat credit etc. should be submitted to Assistant / Deputy Commissioner.

In *Kwality Zipper* v. *CCE* 2002(145) ELT 296 (CEGAT), it was held that even if amalgamation is sanctioned by High Court from a later date, the clubbing provisions to decide SSI exemption limit will be effective from the transfer date as specified in the scheme. In this case, transfer date was 1-4-1999 while order of Court sanctioning amalgamation was made on 14-12-1999. However, it was held that clubbing provisions will apply w.e.f. 1-4-1999. It was also held that assessee should inform department as soon as Board resolution is passed.

Customs – (1) The company may be holding DEPB Pass Book, Advance License, EPCG licenses etc. These should be got amended by changing name of the company. (2) Pending applications for duty drawback should be amended to incorporate new name. (3) Outstanding export obligations under earlier licenses should be got transferred in name of new amalgamated company. (4) Wherever bonds were executed with customs authorities, these should be got amended with new name or new bonds should be executed and old bonds should be got cancelled.

Central Sales Tax – (1) CST Registration certificate shall be got amended to incorporate new name. (2) Security given while obtaining CST registration should be amended / modified / replaced (3) Sale of business is not 'sale of goods'. Hence, scheme should not provide for sale of individual assets.

14.7 INCOME TAX EXEMPTIONS TO DEVELOPER AND SEZ UNIT

As per section 10A(1A) of Income Tax Act, units in SEZ set up upto 31-3-2005 will be exempt from income tax for first five years from year of commencement of manufacture. For subsequent two years, income tax exemption will be 50% of their export income.

In respect of units set up in SEZ on or after 1-4-2005, income tax exemption will be available as per provisions of section 10AA of Income tax Act (inserted w.e.f. 10-2-2006). It will be 100% for five years and 50% for next five years.

Developer of SEZ can claim exemption u/s 80-IA (for SEZ notified upto 31-3-2005)or 80-IAB of Income tax Act (for SEZ notified on or after 1-4-2005).

Dividend distribution tax payable u/s 115-O of Income tax Act is also exempt.

In case of trading, income tax benefits are available only in case of re-exports [see *explanation* to rule 76].

14.7.1 Income tax Exemptions to new units in SEZ

Section 10AA of Income-tax Act makes provision for exemption to units newly established in SEZ on or after 1-4-2005. The conditions are as follows -

- **Assessee should be 'entrepreneur' (i.e. person who has been granted approval by Development Commissioner) as per section 2(j) of SEZ Act.**
- **The unit should manufacture or produce article or things during financial year 2005-06 or any subsequent year [Definition of 'manufacture' is very wide, as discussed earlier.**
- **Assessee should export his goods or services by any mode - physical or otherwise.**
- **Unit should not be formed by splitting up or reconstruction of existing business.**
- **It should not be formed by transfer to a new business, machinery used earlier for any purpose.**
- **Taxpayer should maintain proper accounts which should be audited. He should submit audit report in form 56F along with his return of income.**
- **Second hand capital goods can be imported if these satisfy requirement of section 10AA(4) read with explanation I to section 80-IA of Income Tax Act.**

In case of trading, income tax benefits are available only in case of re-exports [see *explanation* to rule 76].

Deduction allowable - If these conditions are satisfied, deduction is available in respect of profits derived from exports or articles or things or services (including computer software). Profit is calculated as (profit of business of undertaking x Export Turnover)/total turnover of business of undertaking.

Profit and gains derived from site development of computer software (including services for development of software) will be deemed to be profits from export of computer software. However, 'export turnover' will not include freight, telecommunication charges, outward insurance and expenses incurred in foreign exchange in providing technical services outside India.

100% deduction will be available for first five consecutive assessment years. Deduction will be 50% for next 5 years.

SEZ Re-investment allowance reserve - For eleventh to fifteenth assessment year, deduction of 50% of profit will be available, if an equivalent amount is debited to P&L account and credited to SEZ Re-investment Allowance Reserve Account. This Special Reserve should be utilised for purpose of acquiring new plant and machinery within three years. Till then, the amount can be utilised for business purposes. Details of purchases of machinery should be submitted in form 56FF with return of income.

Amalgamation or demerger - Deduction is available if undertaking is transferred to another company under a scheme of amalgamation or demerger. However, deduction will not be admissible to the amalgamating company or the demerged company for the previous year in which amalgamation or demerger takes place.

No deduction of unabsorbed depreciation etc. - If deduction is claimed u / s 10AA of Income-tax Act unabsorbed depreciation allowances or unabsorbed capital expenditure on scientific research or family planning (pertaining to assessment year 2005-06 or earlier years) will not be allowed to be carried forward and set off. Losses u / s 72(1), 74(1) or 74(3) of Income-tax Act will not be allowed to be carried forward.

Depreciation compulsory - Depreciation will be allowed on WDV in respect of each assessment year.

14.7.2 Income tax Exemptions to developer of SEZ

Exemption to developer of SEZ will be available under section 80-IAB of Income-tax Act in respect of developers of SEZ notified on or after 1-4-2005. The accounts should have been audited and return of income for assessment year 2006-07 should be filed on or before due date. Otherwise, deduction under this section will not be available.

Deduction will be for 10 consecutive assessment years. The taxpayer can claim deduction for any 10 consecutive assessment years out of 15 consecutive years, beginning from the year in which SEZ has been notified by Central Government.

If taxpayer transfers the operations/maintenance of zone to another developer (or there is amalgamation with another company), the transferee will be eligible for deduction for remaining period.

If deduction is claimed u / s 80-IAB of Income-tax Act, deduction to the extent of such profits and gains will not be allowed under sections 80HH to 80RRB of Income-tax Act.

14.7.3 Exemption to capital gains from transfer of capital assets

Capital gains arising from transfer of capital assets in case of shifting from urban area to SEZ are exempt as per section 54GA of Income Tax Act. Capital asset may be plant, machinery, land or building or any right in land or building.

Amount of exemption will be equal to - (a) Amount of capital gains in shifting or (b) Cost and expenses incurred in shifting etc., whichever is lower.

If capital gains are not utilised for purchase or construction of new assets, the amount should be deposited in a public sector bank in accordance with Capital Gains Accounts Scheme. The provisions are similar to sections 54 and 54B.

14.7.4 Exemption from dividend distribution tax

Section 111-O(6) of Income Tax Act provides that dividend distribution tax will not apply in respect of total income of SEZ developer or SEZ unit or any amount declared, distributed or paid as dividend by the enterprise or SEZ developer, either in the hands of developer or enterprise or person receiving the dividend.

The dividend referred to in section 115-O will not be included in total income of assessee, being a Developer or entrepreneur [explanation to section 10(34) of Income Tax Act].

14.8 TRANSFER PRICING

Concept of transfer pricing is mainly for taxation of international transaction. Sections 92 to 92F of Income Tax Act provide a statutory framework for computation of reasonable, fair and equitable profit and tax in India so that the profits chargeable to tax in India do not get diverted elsewhere by altering the prices charged and paid in intra-group transactions. Any income arising from an international transaction shall be computed having regard to arm's length price.

International transaction is subjected to the arm's length price only in case of transaction between two entities called associate enterprises.

Enterprise **-** Enterprise means a person who engages or has been engaged or proposed to engage in the following activities - (a) any activity relating to the production, storage, supply, distribution, acquisition or control of articles or goods (b) know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights (c) any activity relating to the provision of services of any kind (d) carrying out any work in pursuance of a contract (*e.g.*, construction contract) (e) investment activity (f) activity relating to provision of loan (g) business of acquiring, holding, underwriting or dealing with shares, debenture or other securities of any body corporate [SEC. 92F(iii)]

A person would be an enterprise if it carries on the specified activity / business directly or through one or more of its units or divisions or subsidiaries.

Associate Enterprise - - The provisions regarding taxation of international transactions [sections 92 to 92F] apply in case the two enterprises are associated enterprises.

An enterprise would be regarded as an associated enterprise of another enterprise, if (a) it participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or (b) in respect of it one or more persons who

participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise [Section 92A(1)].

Deemed associate enterprise - Section 92A(2) provides that two enterprises shall be deemed to be associated enterprises if for the purpose of section 92A(1), the two enterprises satisfy, at any time during the previous year, any of the conditions as specified in section 92A(2)].

Deemed International Transaction - Section 92B(2) provides that transactions between an enterprise and another person is deemed as transactions entered into between two associated enterprises if (a) there is a prior agreement in relation to the relevant transaction between such other person and the associated enterprise; ***or*** (b) the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

Transaction - The transaction includes an arrangement, understanding or action in concert, whether or not such arrangement, understanding or action is formal or in writing; or is intended to be enforceable by legal proceeding [section 92F]. Thus it is inclusive definition.

14.8.1 Computation of the arm's length price

If there is transaction between two entities called associate enterprises, arm's length price will be computed for income tax purposes.

Arm's length price is the price applied (or proposed to be applied) when two unrelated persons enter into a transaction in uncontrolled conditions [section 92F]

Persons are said to be unrelated if they are not associated or deemed to be associated enterprise according to section 92A.

Method of computing arm's length price - Arm's length price can be computed by one of the following methods [section 92C]

a. Comparable uncontrolled price method

b. Resale price method

c. Cost *plus* method

d. Profit split method

e. Transactional net margin method

f. Such other method as may be prescribed by the Board.

Comparable uncontrolled price method - Under this method, the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, (*i.e.,* a transaction between enterprises other than associated enterprises whether resident or non-resident) or a number of such transactions, is identified. The price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transactions or

between the enterprises entering into such transactions, which could materially affect the price in the open market. The adjusted price arrived at is taken to be an arm's length price.

Resale price method - Under this method, the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified. The resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions. The price is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services. The price is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market. The adjusted price arrived at is taken to be an arm's length price.

Cost plus method - Under this method, the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined. The amount of a normal gross profit mark-up to such costs arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined. The normal gross profit mark-up is adjusted to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market. The cost is increased by the adjusted profit. The sum so arrived at is taken to be an arm's length price.

Profit Split Method - This method is used in transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction. In this method, the combined net profit of the associated enterprises arising from the international transaction in which they are engaged, is determined. Then relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data. The profit thus apportioned to the assessee is taken into account to arrive at an arm's length price.

Transactional Net Margin - In this method, the net profit margin realised by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base. The net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base. The net profit margin arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount

of net profit margin in the open market. The net profit margin realised by the enterprise is established. The net profit margin thus established is then taken into account to arrive at an arm's length price.

14.8.2 Selecting Most appropriate method

The arm's length price shall be determined having regard to the most appropriate method. The most appropriate method shall be the method which is best suited to the facts and circumstances of each particular transaction, and which provides the most reliable measure of an arm's length price in relation to an international transaction [section 92C]

14.8.3 Determination of arm's length price by Assessing Officer

The Assessing Officer may determine the arm's length price, in a proceeding for assessment of income, if the Assessing Officer is of the 'opinion' that the arm's length price charged or paid in an international transaction has not been determined in accordance with section 92C(1) or 92C(2) or assessee has not kept the prescribed information and document relating to an international transaction; or information or data used for consulting the arm's length price is not reliable or correct; or assessee has failed to furnish, within the time specified any information or document which was required to be furnished by the Assessing Officer [Sec. 92C(3)]

14.8.4 Report from Chartered Accountant

The report from an accountant which is required to be furnished under section 92E by Every person who has entered into an international transaction during the previous year shall submit report in Form No. 3CEB and be duly verified It shall be furnished before the due date of submission of return of income [section 92E]

14.9 PRACTICAL EXAMPLES

A company engaged in pharmaceutical business commenced business in May 2007. incurred following expenditure relating to scientific research– (a) Capital expenditure of Rs 3 lakhs in April 2007 (b) The company had incurred revenue expenditure on raw material and salaries, of Rs two lakhs in 2003-04, Rs one lakh in 2004-05, Rs three lakhs in 2005-06, Rs two lakhs in 2006-07 and Rs four lakhs in 2007-08 on scientific research. (c) The machinery was sold in February 2008 for Rs five lakhs. Compute (i) deduction allowable in AY 2008-09 and (ii) Capital gains on sale of asset

Ans - Deduction allowable u/s 35 of Income Tax Act is as follows –

Revenue expenditure in three previous years (1+3+2)	**Rs 6 lakhs**
Capital expenditure in current year – 150% of Rs 3 lakhs	**Rs 4.50 lakhs**
Revenue expenditure in current year – 150% of Rs 4 lakhs	**Rs 6 lakhs.**
Total	**Rs 16.50 lakhs**

Short term capital gains on sale of machinery –Sale proceeds – Rs 5 lakhs. Less – Amount deemed as income u/s 41(3) of Income Tax Act – Rs 4.50 lakhs.

Hence, amount of short term capital gains is Rs 50,000.

Mr. X , resident in India, completed 65 years of age on 31-3-2008. His income for the financial year 2007-08 is as under:

(a) Pension-Rs 84,000

(b) Income from Post Office Monthly Income Scheme-Rs. 48,000

(c) Interest from company fixed deposits-Rs. 60,000

(d) Rent from house property owned by him Rs. 2,000 per month NSCs purchased during 2006-07 Rs. 20,000

Calculate the tax liability of Mr. X for the Assessment Year 2008-09.

Computation of gross total income of Mr. X for the assessment year 2008-09

Particulars	Rs	Rs
(A)Income from Salaries (pension)		84,000
Rent(annual value)	24,000	
Less: Deduction u / s 24*(a)*-30% of Rs. 24,000	7,200	
(B) Income from house property		16,800
(C) Income from other sources (interest income)		1,08,000
Gross total income (A) +(B)+(C)		2,08,800
Less: deduction under Chapter VI-A (NSC-section 80C)		20,000
Total Income		1,88,800

Tax on total income of Rs. 1,88,800

On first Rs. 1,85,000-	Nil
On balance Rs. 3,800 (@ 20%)-	Rs. 760
Tax on total income is	Rs. 760

Notes:

1. The Finance Act, 2005 prescribes a basic exemption limit of Rs. 1,85,000 for a senior citizen. A senior citizen is a resident individual who is 65 years or more of age *at any time during the previous year*. In view of this, Mr. X who turns 65 on the last day of the previous year is eligible for basic exemption of Rs. 1,85,000.

2. Standard deduction under section 16*(i)* is not available with effect from Assessment Year 2006-07. So, entire pension will be taxable.

3. **Section 80L deduction is not available with effect from Assessment Year 2006-07. So, entire interest from Post Office MIS is taxable.**

Mr. A who is resident in India wins a lottery of Rs. 10,00,000 during the financial year 2007-08. He is a daily wage-earner who earns on an average Rs. 2,000 per month. He won the prize in December 2007 and received it in the same month after deduction of TDS of 33..66%. He invested Rs. 6,00,000 in Post Office MIS in joint name with his wife. With the balance amount, he started a small business in January, 2008. His income from business for 3 months (January, 2008 to March, 2008) is Rs. 24,000. His Post Office MIS income is Rs. 12,000 (for 3 months). Calculate his tax liability for the assessment year 2008-09

This case is directly covered by section 115 BB. According to the said section, where the total income of an assessee includes winnings from lotteries, the income tax payable shall be the aggregate of :

(i) income tax on lottery calculated at the rate of 30%; and

(ii)the income-tax which the assessee would have been chargeable had his total income been reduced by the amount of income by way of winnings from lottery.

His income other than by way of lottery for assessment year 2006-07 is as under:

Salary for 9 months	18,000
Interest from Post Office MIS	12,000
Income from business	24,000
Income from business	24,000
GROSS TOTAL INCOME (other than lottery)	*54,000*
Less; Chapter VIA deductions	Nil
TOTAL INCOME (other than lottery)	54,000

Tax on total income other than lottery is Nil since it is below the basic exemption limit of Rs. 1,00,000. On lottery, the TDS deducted is his tax liability. He does not have to shell out anything more than the TDS from his pocket. However, by virtue of section 115BB, he cannot utilize the balance Rs. 46,000 out of his basic exemption limit against the lottery income and cannot claim any refund of TDS deducted from lottery winnings. Section 115BB is harsh.

Mrs. X is a qualified cost accountant. She is a salaried employee in a firm of cost accountants in which Mr. X (her husband) is a partner . Mr. X's share in the firm is 20%. Mrs. X draws a salary of Rs. 8,000 per month from the firm. Mr. X's income by way of sitting fees from the various boards of the companies in which he is an independent director is Rs. 1,50,000. Will Mrs. X's income be clubbed with that of Mr. X under section 64 of the Income-Tax Act.

Section 64(1)(ii) provides for clubbing of income arising to spouse of individual by way of salary from a concern in which such individual has a substantial interest (20% or more interest) if the individual's total income before including the salary is greater than the spouse's total income. However, the proviso to section 64(1)(ii) provides that such the provisions of section 64(1)(ii) will not apply to any income earned by spouse if the spouse possesses technical qualifications and the income is solely attributable to the application of his or her technical knowledge or professional knowledge or experience. Therefore, the case appears to fall squarely within the aforesaid proviso and the clubbing provisions of section 64(1)(ii) cannot be invoked to club the salary income of Mrs. X in Mr. X's hands. However, if Mrs. X is a dummy employee, then section 64(1)(ii) will be applicable as the proviso not only envisages the spouse possessing qualifications but also application of such qualifications to derive the income.

A company withdraws Rs. 2,00,000 in cash from its current account maintained with a particular branch of State Bank of India situated at New Delhi on 31-1-2007. What will be the tax payable on cash withdrawal under Banking Cash Transaction Tax? Would your answers be different if the company withdrew Rs. 1,00,000 each from its current accounts maintained with two different branches of the said bank located in New Delhi?

Ans - Banking Cash Transaction Tax will be charged and collected by the bank at the rate of 0.1% of Rs. 2,00,000-*i.e.* Rs. 200 if cash withdrawal from an account with a scheduled bank in a single day exceeds Rs. 1,00,000. The bank will not deduct this from withdrawal amount. It will pay full Rs. 2,00,000 and debit Rs. 200 to the current account. The total debit to the current account would be Rs. 2,00,200. There is no provision in the Income-Tax Act, 1961 to disallow cash withdrawals. The tax of Rs. 200 is deductible expense in computing profits and gains from business or profession. If Rs. 1,00,000 each is drawn from two different accounts, BCTT is not attracted.

Mr. Z had acquired house property in 1989-90 for Rs 5,00,000. He sold the property in 2007-08 for Rs 20,00,000. Cost inflation index was 172 in 1989-90 and 551 in 2004-05. Compute long term capital gain.

Indexed cost of acquisition is 5,00,000 x 551 / 172 i.e. 16,20,588. Hence, long term capital gain is = 20,00,000 –16,20,588 i.e. 3,79,412 .

Mr. A ,an individual, aged 50, has made the following payments during the financial year 2007-08:

(a) Prepayment of entire outstanding housing loan balance of Rs. 80,000 as on 1-4-2007. The loan was taken from HDFC Ltd. 10 years ago. He repaid this amount out of the maturity proceeds of his life insurance policy (Rs. 1,90,000) which he received on 1-4-2007.

(b) He contributed Rs. 15,000 to recognized provident fund (by way of deduction from salary).

(c) He purchased National Savings Certificates Rs. 5,000 in the name of his wife.

(d) He paid his health insurance premium of Rs. 10,000 through his credit card on 31-3-2008. He paid the credit card company the amount on 25-4-2008.

What is the amount of deduction to which Mr. A is entitled to under sections 80C and 80D for the assessment year 2008-09?

There is no stipulation in section 80C that the payments/deposits/investments mentioned therein should be made out of income chargeable to tax. Admittedly, Mr. A has made the prepayment of housing loan from income which is not chargeable to tax [*i.e. LIC* policy proceeds which are exempt from tax under section 10(10D)]. However, this will not disentitle him to the deduction for prepayment of housing loan which is available under clause *(xviii)* of section 80C(2).

The contributions towards recognized provident fund of Rs. 15,000 is deductible under clause *(vi)* of section 80C(2). The amount invested in NSC under section 80C(2)(ix) is not **deductible under clause *(ix)* of section 80C(2) as these are in the name of spouse. Only Life insurance premium [80C(2)(i)], deferred annuity contribution [80C(2)(ii)], contribution to Public Provident Fund Account [80C(2)(v)] contribution to Unit Linked Insurance Plan [80C(2)(x)/(xi)] made in spouse's name are deductible under section 80C.**

The total contributions are Rs. 1,00,000 which is within the overall ceiling of Rs. 1,00,000 stipulated by section 80C and hence fully deductible from gross total income.

.The Finance Act,2007 has amended section 80D w.e.f.Assessment Year 2008-09 to provide that deduction is available if premium is paid by any mode of payment other than cash. **In terms of the Memorandum Explaining the provisions of the Finance Bill,2008 and CBDT's Circular No.3/2008 dated 12-3-2008, payment by credit card is "any mode of payment other than cash" and payment through it is allowable as a deduction. Para 32.3 of the said Circular reads as under:**

"32.3 With a view to allow deduction for *payments made through electronic mode, credit card, etc*., the provisions of section 80D and clause (ib) of sub-section (1) of section 36 have been amended so as to provide that the payment of premium made by any mode *other than cash*, shall be eligible for deduction under these sections."

The following data regarding normal tax liability and tax liability of a company under section 115JB (i.e. MAT) is given for Assessment Years 2006-07 to 2012-13. Calculate the tax payable by

the assessee for each of the said assessment years, MAT Credit available for carry forward under section 115JAA and MAT credit utilized.

A.Y.	**Normal tax *Liability (Rs. Crores)***	**Tax liability *Under section 115JB (Rs. Crores)***
(1)	***(2)***	***(3)***
2006-07	**100**	**300**
2007-08	**120**	**90**
2008-09	**150**	**110**
2009-10	**180**	**200**
2010-11	**200**	**150**
2011-12	**225**	**175**
2012-13	**250**	**200**

A.Y.	Normal tax *liability*	Tax liability *Under section 115JB*	*Higher of (2) and (3)*	*Tax actually Payable* (After consider- *Ing utilization* Of *Credit under Section 115JAA)*	*Addit-ional Tax liability (4)-(2)*	*Credit under Section 115JAA utilised*	*Credit Available for Carry forward*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(5)*	*(6)*	*(7)*
2006-07	100	300	300	300	200	----	200
2007-08	120	90	120	***90*** (*see note 1)*	**Nil**	30	170
2008-09	150	110	150	110 (*see note 1)*	*Nil*	40	130
2009-10	180	200	200	200	20	----	150
2010-11	200	150	200	150 (*see note 1)*	*Nil*	50	100
2011-12	225	175	225	175 (*see note 1)*	*Nil*	50	20 (*see note 2)*
2012-13	250	200	250	230 (*see note 1)*	**Nil**	20 (*see note 2)*	---

Notes:

1. **Mat credit will be allowed to be utilized by way of set-off against tax liability in those years in which normal tax liability exceeds liability determined under section 115JB. The amount of set-off allowed will be the lower of the two amounts:**

(a) MAT credit available; and

(b) The amount by which normal tax liability exceeds liability determined under section 115JB.

2. **Utilisation of credit is permissible upto 5 assessment years immediately following the assessment year in which credit has arisen. If not utilised within the said period, credit will lapse. Out of the credit of Rs. 50 crores available at the end of assessment year 2011-12, Rs. 20 crores has arisen in A.Y. 2009-10 and the balance Rs. 30 crores had arisen in A.Y. 2006-07. In view of the fact that 5 years period expires, the credit of Rs. 30 crores and cannot be carried forward. To determine the amount of lapsed credit, one should adopt, the "first arisen first utilized" basis. That is credit which has arisen first is utilised first.**

The accounts of ABC Co. Ltd. have been prepared in accordance with the provisions of Companies Act. The profit and loss account laid before the annual general meeting for the previous year ending 31.3.2008 shows a net profit of Rs. 40 lakhs. The profit and loss account contains the following credits/debits:

Credits in profit and loss account –

(1)	**Profit from a new industrial undertaking qualifying for deduction under section 80-IB (Net)**	**Rs 14,00,000**
(2)	**Gross Receipts of a newly established 100% export oriented undertaking qualifying for deduction under section 10B**	**Rs 20,00,000**
(3)	**Capital gains on transfer of factory building, being a depreciable asset, held for 5 years by ABC Co. Ltd.**	**Rs 5,00,000**

Debits in profit and loss account

(1)	**Expenditure relating to the newly established 100% export oriented undertaking qualifying for deduction under section 10B**	**Rs 15,00,000**
(2)	**Current year's depreciation**	**Rs 7,50,000**
(3)	**Penalty for infraction of law**	**Rs 50,000**
(4)	**Provision of sales-tax**	**Rs 2,25,000**
(5)	**Proposed dividend**	**Rs 1,75,000**

Following additional information is available –

(1) Brought forward depreciation (relating to A.Y. 2007-08) 8,00,000

(2) Brought forward business loss (relating to A.Y. 2007-08) 12,00,000

(3) Depreciation admissible under the Income-tax Act for the Financial Year 2007-08 is Rs. 15,50,000.

(4) There is no unabsorbed loss or unabsorbed depreciation brought forward from the previous year under the Income-tax Act, 1961.

(5) The company is carrying on scientific and industrial research and development and is eligible for deduction of 100% of its profits under section 80-IB.

(6) The entire capital gain has been invested in specified assets under section 54EC.

(7) Sales tax provided in the accounts has been remitted before the due date.

Compute the taxable income and the tax liability of ABC Co. Ltd. for the A.Y. 2008-09

We have to compute total income as per Income-tax Act as well as book profits. In the case of a company, where 10% of book profits exceeds tax on total income, the book profit shall be deemed to be the total income and the tax payable on such total income shall be 10% thereof plus surcharge plus education cess.

Computation of book profit of ABC Co. Ltd. under section 115JB

Details	Rs.	Rs.
Net profit as per profit and loss account		40,00,000
Add: (i) Proposed dividend	1,75,000	
(ii) Expenditure relating to section 10B unit	15,00,000	
	16,75,000	56,75,000
Less: (i) Income exempt under section 10B	20,00,000	
(ii) Brought forward depreciation [since the same is lower than unabsorbed loss]	8,00,000	
	28,00,000	
Book profit under section 115JB		28,75,000
10% of book profit		2,87,500

Computation of total income of ABC CO. Ltd. under the Income-tax Act

Details	Rs.	Rs.
Net profit as per profit and loss account		40,00,000
Add: Expenses not allowable:		
Penalty for infraction of law	50,000	
Proposed dividend	1,75,000	
Depreciation as per Companies Act	7,50,000	
Sub-total	9,75,000	
		49,75,000
Less:		
Profit eligible for deduction under section 10B [Rs. 20,00,000 - Rs. 15,00,000]	5,00,000	
Capital gains (considered separately)	5,00,000	
Depreciation allowable under the Income-tax Act	15,50,000	
Sub-total	25,50,000	
Profits and gains of business		24,25,000
Long-term capital gain on sale of depreciable asset –exempt since invested in specified assets in specified period		Nil
Gross total income		24,25,000
Less: Deduction u/s 80-IB		14,00,000
Total income		10,25,000

A. Tax on total income as per the Income-tax Act is Rs. 3,07,500 (being 30% of Rs. 10,25,000).

B. 10% of book profit of Rs. 28,75,000 is Rs. 2,87,500.

Since 10% of book profit does not exceed tax on total income, the provisions of section 115JB are not attracted. Hence, the tax payable on total income as per Income-tax Act is as follows Tax on total income - @30% 3,07,500 *Add:* Surcharge @10% 30,750 Sub-total Rs 3,38,250. *Add:* Education cess @2% - Rs 6,765. Add:Secondary Higher Education Cess @1%-Rs3383.00.Hence, tax on total income as per the Income-tax Act is Rs 3,48,398.

Gopal receives the following salary and perquisites from his employer during the previous year 2007-08: Basic pay: Rs. 1,20,000; profit bonus: Rs. 5,500; commission on sales @ 2 per cent of turnover (turnover of the year 2007-08 achieved by Gopal: Rs. 6,00,000); advance salary of April, May and June 2008: Rs. 30,000; employer's contribution towards recognised provident fund: Rs.16,220; interest credited on May 15, 2007 in provident fund account @ 15 per cent: Rs. 8,700; conveyance allowance: Rs. 300 (@ Rs. 100 per month from January 1, 2008 to March 31, 2008 which is fully utilised for official purposes); free services of a gardener (salary : Rs. 8,000); free services of personnel attendant (salary Rs. 9,000) and free services of watchman (salary Rs. 1,200). Apart from taking salary in advance Gopal takes an interest-free loan of Rs. 95,000 on November 1, 2007 from the employer repayable after 3 years for higher education of his daughter (SBI lending rate on April 1, 2007: 10.5 per cent). He owns a house at Calcutta. During the previous year, he earns taxable income of Rs. 1,75,000 from the house. Gopal holds 20 per cent equity shares in the employer-company.

Gopal contribute Rs. 19,500 towards recognised provident fund during the previous year and pays Rs. 8,000 in a bank as a fixed deposit for the purpose of section 80C. Compute the total income and tax payable by Gopal for the assessment year 2008-09.

Ans - Computation of taxable income and tax payable by Gopal for A.Y. 2008-09

Particulars	**Rs.**	**Rs.**
Basic pay		1,20,000
Profit bonus		5,500
Commission on sales (2% of Rs. 6,00,000)		12,000
Advance Salary		30,000
Employer's contribution in excess of 12% of salary (i.e.		380
16,220 – 12% of Rs. 1,32,000) (see Note 1)		
Interest credited to PF account, being the amount in excess		1,740
12% per annum (i.e., Rs. 8,700 X 3 ÷ 15)		
Conveyance allowance		300
Less: Exemption (as it is utilized for official purpose)	300	Nil
Free Gardner		8,000
Free personnel attendant		9,000

Free watchman	1,200
Interest-free loan (interest on Rs. 95,000 @ 10.5% p.a. from	4,156
November 1, 2007 to March 31, 2008) (see Note 2)	
Gross salary	**1,91,976**
Less: Deduction under section 16	-
Net salary	**1,91,976**
Income from house property	1,75,000
Gross total income	**3,66,976**
Less: Deduction under section 80C (see Note 3)	27,500
Total income	**3,39,476**
Tax on total income	
Income-tax	50,844
Add: Surcharge (surcharge is not applicable if total income does	-
Not exceed Rs. 10 lakh)	
	50,844
Add: Education cess @2%	1,017
Add: Secondary and Higher Education cess @1%	508
Tax payable	**52,369**
Tax payable (rounded off)	**52,370**

Notes -

1. As commission is based upon fixed percentage of turnover achieved by Gopal, it will be part of salary for the purpose of determining tax incidence on employer's contribution towards provident fund. For the aforesaid purposes salary would, therefore, be Rs. 1,32,000 (i.e., basic salary Rs.1,20,000 + Rs. 12,000).

2. Salary received in advance is taxable in the year of receipt. Loan taken from the employer is not taxable. However, interest on such loan is taxable.

3. Deduction under section 80C is computed as under: - Contribution towards Recognised PF - Rs 19,500 plus FD in Bank - Rs 8,000. Total deduction - Rs 27,500

STUDY NOTE -15

FRINGE BENEFIT TAX (FBT)

This Study Note includes

- Introduction
- Meaning of Fringe Benefit
- Other Provisions
- Fringe Benefit Tax on ESOPs

15.1 INTRODUCTION

Employer gives various benefits to employees. The benefits which are individually given to employee can be identified with the particular employee and taxed in his hands. However, where benefits are given collectively and it is difficult to identify individual employee, these should be taxed at the hands of employer.

FBT (Fringe Benefit Tax) has been introduced with this idea in mind w.e.f. 1-4-2005 (AY 2006-07).

However, practically, some benefits which can be identified with individual employee are taxable under FBT. Similarly, some expenses incurred by employer which hardly benefit employees are also taxed under FBT.

15.1.1 *Who is 'employer'?*

Employer means a company; a firm; an association of persons or a body of individuals; a local authority; and every artificial juridical person, not falling within any of the above. However, "employer" does not include (*a*) a political party, or (*b*) a person who is eligible for exemption under section 10(*23C*) or registered under section 12AA of Income Tax Act [section 115W(a) of Income Tax Act]

Thus, a proprietary firm or HUF is not liable to pay FBT. Similarly, Central Government; a State Government and a political party is not 'employer' and not liable to pay FBT.

Fringe benefit tax will apply to foreign companies if it has employees based in India. Fringe benefit tax will apply to liaison offices of foreign companies in India if the liaison offices have employees based in India - CBDT Circular No. 8/2005 dated 29-8-2005.

15.1.2 *When FBT is payable?*

As per section 115WA(1), fringe benefit tax is applicable if — (a) Fringe benefits are provided or deemed to be provided (b) These are provided by an "employer" as defined in section 115W(a) and *(c)* These benefits are provided to his employees.

FBT is in addition to income tax. FBT is payable by employer. FBT is calculated at the rate of 30 per cent on the "value" of fringe benefits. In addition, surcharge and education cess is payable. Surcharge is 10% if fringe benefit is above Rs 10 lakhs. Surcharge is 2.5% if employer is non-domestic company and surcharge is Nil if employer is a local authority.

15.2 MEANING OF FRINGE BENEFIT

Fringe Benefits are defined in two parts - (a) Fringe Benefits as defined in section 115WB(1) (b) Deemed Fringe Benefits as defined in section 115WB(2).

Valuation of each fringe benefit is to be done as per provisions of section 115WC.

Perquisites taxable at hands of employees - Perquisites in respect of which tax is paid or payable by the employee are not taxable as perquisites under FBT.

Transport to employees to and from home - Free or subsidised transport or allowance provided by the employer to his employees for journeys by the employees from their residence to the place of work or such place of work to the place of residence will also not be taxable under FBT.

15.2.1 Defined fringe benefits

"Fringe benefits", as defined in section 115WB(1), means any consideration for employment provided by way of the following -

Privilege or facility to employees - It covers any privilege, service, facility or amenity, directly or indirectly, provided by an employer, whether by way of reimbursement or otherwise, to his employees (including former employees). If any amount is recovered from employee, it will be deducted.

Free or concessional ticket for travel - It covers any free or concessional ticket provided by the employer for private journeys of his employees or their family members. It includes free or concessional tickets given by a transport undertaking to its employees and family members. It is not applicable if such tickets are given by an employer who is not engaged in the business of transport undertaking. Leave travel assistance or leave travel concession given by an employer to his employees is not covered by section 115WB(1)(*b*). In respect of transport facility provided by a transport undertaking to its employees, the value of fringe benefit shall be calculated at "cost" of which the same benefit is provided by the employer to the public as reduced by the amount, if any, paid by, or recovered from his employees. The cost at which the ticket is provided by the employer to the general public shall be the price of the ticket which an ordinary passenger is expected to pay on the date of purchase of the ticket for the date, time and the class of travel. Similarly, in a case where an open ticket is issued a number of days in advance but the reservation is generally confirmed a few hours before departure, the value of the free or concessional ticket shall be the cost of the ticket which an ordinary passenger seeking reservation a few hours before departure is liable to pay as reduced by the amount, if any, paid by or recovered from the employees - CBDT Circular No. 8/2005 dated 29-8-2005.

Contribution to superannuation fund - It covers contribution by the employer to an approved superannuation fund for employees. It may be noted that Employers' contribution to an approved superannuation fund is subject to fringe benefit tax. However, employers' contribution to gratuity fund / provident fund is not subject to fringe benefit tax. Value of fringe benefit will be 100% of amount in excess of Rs 1,00,000 for each employee. Thus, contribution upto Rs 1,00,000 per employee will not be considered as fringe benefit.

Security or sweat equity to employee - It covers any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer free of cost or concessional rate to his employee and former employees. Value of fringe benefit will be 100% of fair market value of security or sweat equity on the date on which the option vests with the employee, less amount paid by employee.

15.2.2 Deemed Fringe Benefits

Following benefits shall be deemed to have been provided by the employer to his employees if the employer has in the course of his business and profession incurred these expenses [section 115WB(2) of Income Tax Act]

Entertainment - 20% of expenditure will be considered as value of 'fringe benefit'. It includes the reimbursement of entertainment expenditure by an employer to employees / directors / others and also expenditure on meeting / get-togethers of employees and their family members on non-festival occasions including annual day.

Provision of hospitality - 20% of expenditure will be considered as value of 'fringe benefit'. In case of hotels and carriage of passenger or goods by air / cargo, value of fringe benefits will be only 5%.

It covers provision of hospitality of every kind by the employer to any person, whether by way of provision of food or beverages or in any other manner whatsoever. It includes expenditure on food / meals incurred by employees and later on reimbursed by employer and expenditure on food and beverages provided by employer at a training centre taken on hire by employer. However, it does not include any expenditure on, or payment for, food or beverages provided by the employer to his employees in office or factory and any expenditure on or payment through paid vouchers which are not transferable and usable only at eating joints or outlets.

Conferences - 20% of expenditure will be considered as value of 'fringe benefit'. In case of construction, pharma and software industries, value of fringe benefit will be 5%.

It covers any expenditure on conveyance, tour and travel, on hotel, or boarding and lodging in connection with any conference shall be deemed to be expenditure incurred for the purposes of conference. It includes expenditure on attending training programmes organized by trade bodies and on conferences for agents / dealers / development advisor. However, it does not include the fixed conference allowance to employees / directors, fees for participation by employees in any conference (excluding travelling, boarding and lodging expenses) and expenditure on in house training of employees (excluding travelling, boarding and lodging expenses).

Sale promotion - 20% of expenditure will be considered as value of 'fringe benefit'. It covers sales promotion including publicity. It includes payment for use of brand / brand ambassador / celebrity endorsement but not payment to a person of repute for promoting sales. It expenditure on free offers (with products) such as freebies like tattoos, cricket cards or similar products, to trade or consumers, but does not include expenditure on free samples of products distributed to any person. Expenditure on product marketing research carried on through its own employees is includible.

It does not include the following - (a) Expenditure (including rental) on advertisement of any form in any print (including journals, catalogues or price lists) or electronic media or transport system (b) Expenditure on the holding of, or the participation in, any press conference or business convention, fair or exhibition (c) Expenditure on sponsorship of any sports event or any other event organized by any Government agency or trade association or body (d) Expenditure on the publication in any print or electronic media of any notice required to be published by or under any law or by an order of a court or tribunal (e) Expenditure on advertisement by way of signs, art work, painting, banners, awnings, direct mail, electric spectaculars, kiosks, hoardings, bill boards or display of products or by way of such other medium of advertisement (f) Expenditure by way of payment to any advertising agency for the above purposes (g) Brokerage and selling commission paid for selling goods (h) Expenditure relating to salesmen appointed by distributors for companies' products reimbursed through credit notes (i) Sale discount to wholesellers / customers or bonus points to customers (j) Expenditure on incentives given to distributors for meeting quantity targets (k) Expenditure on product marketing research paid to an outside agency (l) Expenditure in the nature of call centre charges for canvassing sales (cold calls) or carrying out post sales activities (m) Expenditure on making ad-film.

Employees' welfare - 20% of expenditure will be considered as value of 'fringe benefit'. Employees' welfare. It includes the following - (a) Payment for group personal accident / workman compensation insurance not under a statutory obligation (b) Medical expenditure reimbursement up to Rs. 15,000 (c) Expenditure on garden, site cleaning, light decoration etc. in employees colony (d) Expenditure on group health insurance not under a statutory obligation (e) Expenditure at a hospital / dispensary for injuries incurred during course of employment (hospital not run by employer) not under a statutory obligation (f) Subsidy provided to a school not meant exclusively for employees' children (g) Reimbursement of expenditure on books / periodicals to employees (h) Expenditure incurred on prizes / awards to employees (i) Expenditure on providing transport facility to employees' children (j) Expenditure on meeting / get-togethers of employees and their family members on non-festival occasions including annual day.

This does not cover any expenditure incurred or payment made to fulfil any statutory obligation or mitigate occupational hazards or provide first aid facilities in the hospital or dispensary run by the employer. It also does not include medical facilities, reimbursement of medical expenses etc. which are not considered as perquisities of an employee.

Conveyance - 20% is treated as Fringe Benefit. It includes (a) Reimbursement of car expenses including driver salary to employees on the basis of declaration or on the basis of bills submitted by employees (b) Travelling expenditure / conveyance expenditure / tour or travel expenditure incurred in respect of a project assigned by a client which is later on reimbursed by the client (c) allowances for meeting lodging and boarding given to employees.

It does not include Reimbursement of travelling expenditure / conveyance expenditure / tour or travel expenditure to a consultant in respect of a project assigned to him, fixed conveyance allowance / travelling allowance / transport allowance given to employees / director and expenditure for providing leave travel concession (LTC) to employees.

Hotel and lodging - 20% of expenditure will be considered as value of 'fringe benefit'. In case of carriage of passenger / goods by air / ship, pharma and software industries, value of fringe benefit will be 5%.

It covers use of hotel, boarding and lodging facilities. It includes any expenditure on use of hotel, boarding and lodging facilities. It also includes reimbursement of hotel bills to employees / directors. However, it does not include fixed hotel allowance to employees / directors

Repairs and maintenance of motor cars - 20% of expenditure will be considered as value of 'fringe benefit'. In case of carriage of passenger / goods by car business, value of fringe benefit will be 5%.

It covers repair, running (including fuel), maintenance of motorcars and the amount of depreciation thereon. It includes expenditure on repair of motor car, expenditure on running of motor car including fuel, maintenance expenditure of motor car, depreciation of motor car (as per Income-tax Act), lease rent of motor car, salary paid to drivers of motor cars, rent of garage for motor cars and interest on loan taken to purchase motor cars. However, it does not include any expenditure on running, maintenance of delivery vans, display vans, lorries, ambulances, tractors, buses, trucks, tempos, etc.

Repairs and maintenance of aircrafts - It covers repair, running (including fuel) and maintenance of aircrafts and the amount of depreciation thereon. It includes all expenses as applicable to repair and maintenance of motor cars. 20% of expenditure will be considered as value of 'fringe benefit'. In case of carriage of passenger / goods by air business, value of fringe benefit will be Nil.

Telephones - It covers use of telephone (including mobile phone) other than expenditure on leased telephone lines. 20% of expenditure will be considered as value of 'fringe benefit'.

Guest house accommodation - It covers maintenance of any accommodation in the nature of guest house (other than accommodation used for training purposes). 20% of expenditure will be considered as value of 'fringe benefit'.

Festival celebrations - It includes any festival celebration expenditure but does not include expenditure on celebration on Independence Day and Republic Day. 50% of expenditure will be considered as value of 'fringe benefit'.

Use of health club and similar facilities - It includes reimbursement of health club expenditure to employees / directors and payment of entrance fees. It does not include depreciation on club building and fixed club allowance to employees / directors. 50% of expenditure will be considered as value of 'fringe benefit'.

Use of any other club facilities - It includes payment for entrance fees to a club and reimbursement of club expenditure to employees. 50% of expenditure will be considered as value of 'fringe benefit'.

Gifts - Gift may be in cash or kind. Even gifts on promotion of company's products to distributors / retailers are covered under fringe benefit. 50% of expenditure will be considered as value of 'fringe benefit'.

Scholarships - It includes expenditure on training of employees in an educational institute. 50% of expenditure will be considered as value of 'fringe benefit'.

Tour, travel, foreign travel - 5% of expenditure will be considered as value of 'fringe benefit'.

15.3 OTHER PROVISIONS

Advertisement not as deemed benefit - The following expenditure on advertisement shall not be taken as "deemed fringe benefit" * the expenditure (including rental) on advertisement of any form in any print (including journals, catalogues or price lists) or electronic media or transport system * the expenditure on the holding of, or the participation in, any press conference or business convention, fair or exhibition * the expenditure on sponsorship of any sport event or any other event organized by any Government agency or trade association or body * the expenditure on the publication in any print or electronic media of any notice required to be published by or under any law or by an order of a court or tribunal * the expenditure on advertisement by way of signs, art work, painting, banners, awnings, direct mail, electric spectaculars, kiosks, hoardings, bill boards or by way of such other medium of advertisement * the expenditure by way of payment to any advertising agency for the purposes of above * the expenditure on distribution of free samples of medicines or of medical equipment, to doctors * the expenditure by way of payment to any person of repute for promoting the sale of goods or services of the business of the employer.

No segregation of capital/revenue/preoperative expenses - All specified expenses are7 covered under fringe benefit, whether capital or revenue nature - CBDT Circular No. 8/2005 dated 29-8-2005.

Fringe benefit is not allowable as expense under income tax but can be shown as expense in P&L account - For the purposes of computation of total income under the Income-tax Act, fringe benefit tax is not an allowable deduction by virtue of section 40(*a*)(*ic*). However, the accounting treatment of fringe benefit tax for the purposes of reporting to shareholders and complying with the obligations under the Companies Act will be governed by the Accounting Standards issued by the Institute of Chartered Accountants of India - CBDT Circular No. 8/2005 dated 29-8-2005.

FBT is deductible for computing book profit - The fringe benefit tax is an allowable deduction in the computation of 'book profit' under section 115JB - CBDT Circular No. 8/2005 dated 29-8-2005.

15.3.1 Advance payment of fringe benefit tax

Every employer shall pay advance tax on his current fringe benefits. The advance tax shall be payable on basis similar to one under which advance income tax is payable. The only difference is that advance FBT is payable even if tax is less than Rs 5,000.

Interest - For non-payment/short payment of advance fringe benefit tax, interest will have to be paid. The mode of computation of interest as provided in section 115WJ(3)/(4)/(5) is similar to the provisions regulating interest for non-payment or short payment of advance income-tax given in sections 234B and 234C.

15.4 FRINGE BENEFIT TAX ON ESOPS

The Finance Act,2007 has introduced FBT on ESOPs (Employees Stock Option Plan) w.e.f. Assessment Year 2008-09. The salient features of these provisions are:

(i) FBT shall apply in all cases where any specified security or sweat equity shares has been allotted or transferred by the employer to his employees;

(ii) FBT shall be payable in the previous year in which such allotment or transfer has taken place;

(iii) the provisions of this new clause shall apply irrespective of the allotment or transfer being direct or indirect;

(iv) the provisions of this new clause shall apply irrespective of the allotment or transfer being free of cost or at concessional rate;

(v) the provisions of this new clause shall apply irrespective of the allotment or transfer being to current or former employee or employees;

(vi) the provisions of this new clause shall apply in cases where the allotment or transfer is on or after 1st day of April, 2007.

(vii) the value of fringe benefit in such cases shall be determined in accordance with the formula

A-B

Where, A = the Fair Market Value (FMV) of the specified security or sweat equity shares on the date of vesting of the option; and

B = the amount, if any, actually paid by, or recovered from the employee;

FBT is payable only if A exceeds B. No FBT is payable where B exceeds A.

The expressions specified security and sweat equity shares have also been defined. The value of fringe benefit is subjected to FBT at the prevailing rate, which is currently 30% plus surcharge plus education cess.

The expression fair market value has been defined to mean the value determined in accordance with the method as may be prescribed by the Board. Option has been defined to mean a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price.

The Central Board of Direct Taxes (CBDT) vide notification S.O. No. 1805(E) dated 23rd October, 2007 has inserted Rule 40C in the income-tax Rules; which has prescribed the method for determination of fair market value of specified security or sweat equity share, being a share in the company. Salient features of this rule are:

(i) In a case where, on the date of the vesting of the option, the share in the company is listed on a recognized stock exchange, the fair market value shall be the average of the opening price and closing price of the share on that date on the said stock exchange;

(ii) If on the date of vesting of the option, the share is listed on more than one recognized stock exchanges, the fair market value shall be the average of opening price and closing price of the share on the recognised stock exchange which records the highest volume of trading in the share;

(iii) If on the date of vesting of the option, there is no trading in the share on any recognized stock exchange, the fair market value shall be,-

(a) the closing price of the share on any recognised stock exchange on a date closest to the date of vesting of the option and immediately preceding such date; or

(b) the closing price of the share on a recognised stock exchange, which records the highest volume of trading in such share, if the closing price, as on the date closest to the date of vesting of the option and immediately preceding such date, is recorded on more than one recognized stock exchange.

(iv) In a case where, on the date of vesting of the option, the share in the company is not listed on a recognized stock exchange, the fair market value shall be such value of the share in the company, as determined by a Category 1 Merchant Banker registered with the Security and Exchange Board of India, on the specified date.

(v) The specified date has been defined as to mean,-

(i) the date of vesting of the option; or

(ii) any date earlier than the date of the vesting of the option, not being a date which is more than 180 days earlier than the date of the vesting

Further, the Central Board of Direct Taxes has inserted a new rule 40D in the Income-tax Rules, vide notification S.O. No. 113(E), dated 18-012008, prescribing the method for determination of fair market value of specified security, not being an equity share in the company. Through the same notification, rule 40C has been amended to omit the definition of equity share.

A new section 115WKA has also been inserted enabling the employer to recover the fringe benefit tax from the employee in respect of specified security or sweat equity shares, if such security or shares are transferred or allotted to the employee on or after 1st April, 2007. It has been prescribed that the employer can vary the agreement or scheme under which such specified security or sweat equity shares has been allotted or transferred. The agreement or scheme can be varied with a purpose to recover from the employee the fringe benefit tax to the extent to which such employer is liable to pay the fringe benefit tax in relation to the allotment or transfer of such specified security or sweat equity shares to such employee.

STUDY NOTE-16

WEALTH TAX

This Study Note includes

- Introduction
- Valuation of Assets
- Other Issues relating to Wealth Tax

16.1 Introduction

Wealth tax is not a very important or high revenue tax in view of various exemptions. Wealth tax is a socialistic tax. It is not on income but payable only because a person is wealthy.

Wealth tax is payable on net wealth on 'valuation date'. As per Section 2(q), valuation date is 31st March every year. It is payable by every individual, HUF and company. Tax rate is 1% on amount by which 'net wealth' exceeds Rs 15 lakhs. No surcharge or education cess is payable.

No wealth-tax is chargeable in respect of net wealth of any company registered under section 25 of the Companies Act, 1956; any co-operative society; any social club; any political party; and a Mutual fund specified under section 10(*23D*) of the Income-tax Act [section 45]

Net wealth = Value of assets [as defined in section 2(ea] plus deemed assets (as defined in section 4) less exempted assets (as defined in section 5), less debt owed [as defined in section 2(m)].

Debt should have been incurred in relation to the assets which are included in net wealth of assessee. Only debt owed on date of valuation is deductible.

In case of residents of India, assets outside India (less corresponding debts) are also liable to wealth tax. In case of non-residents and foreign national, only assets located in India including deemed assets less corresponding debts are liable to wealth tax [section 6].

Net wealth in excess of Rs. 15,00,000 is chargeable to wealth-tax @ 1 per cent (on surcharge and education cess).

Assessment year - Assessment year means a period of 12 months commencing from the first day of April every year falling immediately after the valuation date **[Section 2(*d*)]**.

16.1.1 Assets

Assets are defined in Section 2(*ea*) as follows.

Guest house, residential house or commercial building - The following are treated as "assets" - (a) Any building or land appurtenant thereto whether used for commercial or residential purposes or for the purpose of guest house (b) A farm house situated within 25 kilometers from the local limits of any municipality (whether known as a municipality, municipal corporation, or by any other name) or a cantonment board [Section 2(ea)(i)]

A residential house *is* not asset, if it is meant exclusively for residential purposes of employee who is in whole-time employment and the gross annual salary of such employee, officer or director is less than Rs. 5,00,000.

Any house (may be residential house or used for commercial purposes) which forms part of stock-in-trade of the assessee is not treated as "asset".

Any house which the assessee may occupy for the purposes of any business or profession carried on by him is not treated as "asset".

A residential property which is let out for a minimum period of 300 days in the previous year is not treated as an "asset".

Any property in the nature of commercial establishments or complex is not treated as an "asset".

Motor cars - Motor car is an "asset", but not the following - (a) motor cars used by the assessee in the business of running them on hire (b) motor cars treated as stock-in-trade [Section 2(ea)(ii)]. In the case of a leasing company, motor car is an asset.

Jewellery, bullion, utensils of gold, silver, etc. [Section 2(ea)(iii)] - Jewellery, bullion, furniture, utensils and any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals are treated as "assets" [Section 2(ea)(ii)]

For this purpose, "jewellery" includes ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, and also precious or semi-precious stones, whether or not set in any furniture, utensils or other article or worked or sewn into any wearing apparel.

Where any of the above assets (*i.e.*, jewellery, bullion, utensils of gold, etc.) is used by an assessee as stock-in-trade, then such asset is not treated as "assets" under section 2(*ea*)(*iii*).

Yachts, boats and aircrafts - Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes) are treated as "assets" [Section 2(ea)(iv)]

Urban land - Urban land is an "asset" [Section 2(ea)(v)]

Urban land means land situated in the area which is comprised within the jurisdiction of a

municipality and which has a population of not less than 10,000 according to the last preceding census.

Land occupied by any building which has been constructed with the approval of the appropriate authority is not 'asset'.

Any unused land held by the assessee for industrial purposes for a period of 2 years from the date of its acquisition by him is not an asset. Any land held by the assessee as stock-in-trade for a period of 10 years from the date of its acquisition by him is also not an asset.

Cash in hand - In case of individual and HUF, cash in hand on the last moment of the valuation date in excess of Rs. 50,000 is an 'asset'. In case of companies, any amount not recorded in books of account is 'asset' [Section 2(ea)(vi)]

16.1.2 Deemed assets

Often, a person transfers his assets in name of others to reduce his liability of wealth tax. To stop such tax avoidance, provision of 'deemed asset' has been made. In computing the net wealth of an assessee, the following assets will be included as deemed assets u/s 4.

Assets transferred by one spouse to another - The asset is transferred by an individual after March 31, 1956 to his or her spouse, directly or indirectly, without adequate consideration or not in connection with an agreement to live apart will be 'deemed asset' [Section 4(1)(a)(i)]

If an asset is transferred by an individual to his/her spouse, under an agreement to live apart, the provisions of section 4(1)(*a*)(*i*) are not applicable. The expression "to live apart" is of wider connotation and even the voluntary agreements to live apart will fall within the exceptions of this sub-clause.

Assets held by minor child - In computing the net wealth of an individual, there shall be included the value of assets which on the valuation date are held by a minor child (including step child/adopted child but not being a married daughter) of such individual [Section 4(1)(a)(ii)]

The net wealth of minor child will be included in the net wealth of that parent whose net wealth [excluding the assets of minor child so includible under section 4(1)] is greater.

Assets transferred to a person or an association of persons - An asset transferred by an individual after March 31, 1956 to a person or an association of person, directly or indirectly, for the benefit of the transferor, his or her spouse, otherwise than for adequate consideration, is 'deemed asset' of transferor [Section 4(1)(a)(iii)]

Assets transferred under revocable transfers - The asset is transferred by an individual to a person or an association of person after March 31, 1956, under a revocable transfer is 'deemed asset' of transferor [Section 4(1)(a)(iv)]

Assets transferred to son's wife [Section 4(1)(a)(v)] - The asset transferred by an individual after May 31, 1973, to son's wife, directly or indirectly, without adequate consideration will be 'deemed asset' of transferor [Section 4(1)(a)(iv)]

Assets transferred for the benefit of son's wife - If the asset is transferred by an individual after May 31, 1973, to a person or an association of the immediate or deferred benefit of son's wife, whether directly or indirectly, without adequate consideration, it will be treated as 'deemed asset' of the transferor [Section 4(1)(a)(vi)].

Interest of partner- Where the assessee (may or may not be an individual) is a partner in a firm or a member of an association of persons, the value of his interest in the assets of the firm or an association shall be included in the net wealth of the partner / member. For this purpose, interest of partner / member in the firm or association of persons should be determined in the manner laid down in Schedule III to the Wealth-tax Act [Section 4(1)(b)].

Admission of minor to benefits of the partnership firm - If a minor is admitted to the benefits of partnership in a firm, the value of his interest in the firm shall be included in the net wealth of parent of minor in accordance with the provisions of section 4(1)(*a*)(*ii*) [*see* para 546.2]. It will be determined in the manner specified in Schedule III.

Conversion by an individual of his self-acquired property into joint family property - If an individual is a member of a Hindu undivided family and he converts his separate property into property belonging to his Hindu undivided family, or if he transfers his separate property to his Hindu undivided family, directly or indirectly, without adequate consideration, the converted or transferred property shall be deemed to be the property of the individual and the value of such property is includible in his net wealth [Section 4(1A)]

If there was such transfer and if the converted or transferred property becomes the subject-matter of a total or a partial partition among the members of the family, the converted or transferred property or any part thereof, which is received by the spouse of the transferor, is deemed to be the asset of the transferor and is includible in his net wealth.

Gifts by book entries - Where a gift of money from one person to another is made by means of entries in the books of account maintained by the person making the gift, or by an individual, or a Hindu undivided family, or a firm or an association of persons, or a body of individuals with whom he has business connection, the value of such gift will be included in the net wealth of the person making the gifts, unless he proves to the satisfaction of the Wealth-tax Officer that the money had actually been delivered to the other person at the time the entries were made [Section 4(5A)]

Impartible estate - For the purpose of the Wealth-tax Act, the holder of an impartible estate shall be deemed to be the owner of all the properties comprised in the estate [Section 4(6)]

Property held by a member of a housing society - Where the assessee is a member of a co-operative housing society and a building or part thereof is allotted or leased to him, the assessee is deemed to be the owner of such building and the value of such building is includible in computing his net wealth. In determining the value of such building, any outstanding instalments, payable by the assessee to the society towards the costs of such house, are deductible as debt owed by the assessee. The above rules are also applicable if the assessee is a member of a company or an association of persons [Section 4(7)]

Property held by a person in part performance of a contract [Section 4(8)] - A person who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882. Similarly, a person can acquire any rights, excluding any rights by way of a lease from month to month or for a period not exceeding one year, in or with respect to any building or part thereof, by virtue of transaction as is referred to in section 269UA(f) of the Income-tax Act.

In above cases, the assets are taxable in the hands of beneficial owners, in the same manner in which they are taxed under the Income-tax Act :

16.1.3 Assets which are exempt from tax

The following assets are exempt from wealth-tax, as per section 5.

Property held under a trust - Any property held by an assessee under a trust or other legal obligation for any public purpose of charitable or religious nature in India is totally exempt from tax. [Section 5(i)].

Business assets held in trust, which are exempt - The following business assets held by as assessee under a trust for any public charitable / religious trust are exempt from tax - (a) where the business is carried on by a trust wholly for public religious purposes and the business consists of printing and publication of books or publication of books or the business is of a kind notified by the Central Government in this behalf in the Official Gazette (b) the business is carried on by an institution wholly for charitable purposes and the work in connection with the business is mainly carried on by the beneficiaries of the institution (c) the business is carried on by an institution, fund or trust specified in sections 10(23B) or 20(23C) of the Income-tax Act.

Any other business assets of a public charitable / religious trust is not exempt.

Coparcenary interest in a Hindu undivided family - If the assessee is a member of a Hindu undivided family, his interest in the family property is totally exempt from tax [Section 5(ii)].

Residential building of a former ruler - The value of any one building used for the residence by a former ruler of a princely State is totally exempt from tax [Section 5(iii)]

Former ruler's jewellery - Jewellery in possession of a former ruler of a princely State, not being his personal property which has been recognised as a heirloom is totally exempt from tax [Section 5(iv)]

The jewellery shall be permanently kept in India and shall not be removed outside India except for a purpose and period approved by the Board. Reasonable steps shall be taken for keeping that jewellery substantially in its original shape. Reasonable facilities shall be allowed to any officer of the Government, or authorised by the Board, to examine the jewellery as and when necessary.

Assets belonging to the Indian repatriates - Assets (as given below) belonging to assessee who is a person of Indian origin or a citizen of India, who was ordinarily residing in a foreign

country and who has returned to India with intention to permanently reside in India, is exempt. A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grand-parents, was born in undivided India.

After his return to India, following shall not be chargeable to tax for seven successive assessment years - (a) moneys brought by him into India (b) value of asset brought by him into India (c) moneys standing to the credit of such person in a Non-resident (External) Account in any bank in India on the date of his return to India and (d) value of assets acquired by him out of money referred to in (*a*) and (*c*) above within one year prior to the date of his return and at any time thereafter [Section 5(v)]

One house or part of a house - In the case of an individual or a Hindu undivided family, a house or a part of house, or a plot of land not exceeding 500 sq. meters in area is exempt. A house is qualified for exemption, regardless of the fact whether the house is self-occupied or let out. In case a house is owned by more than one person, exemption is available to each co-owner of the house [Section 5(vi)]

16. 2 VALUATION OF ASSETS

The value of an asset, other than cash, shall be its value as on the valuation date determined in the manner laid down in Schedule III.

Valuation of a building - Value of any building or land appurtenant thereto, or part thereof, is to be made in accordance with Part B of Schedule III to the Wealth-tax Act

The first step is to find out gross maintainable rent. Gross maintainable rent is (a) annual rent received / receivable by the owner or annual value of the property as assessed by local authority, whichever is higher (if the property is let out) or (b) annual rent assessed by the local authority or if the property is situated outside the jurisdiction of a local authority, the amount which the owner can reasonably be expected to receive as annual rent had such property been let (if the property is not let).

In the following cases "actual rent" shall be increased in the manner specified below : (a) Taxes borne by tenant (b) If property is rented, one-ninth of actual rent will be added, if expenditure on repairs in respect of the property is borne by the tenant (c) Interest @ 15% on deposit given by tenant or difference (d) Premium received as consideration for leasing of the property or any modification of the terms of the lease will be divided over the number of years of the period of the lease and will be added to 'actual rent' (d) If the derives any benefit or perquisite as consideration for leasing of the property or any modification of the terms of the lease), the value of such benefit or perquisite shall be added to actual rent.

Net maintainable rent is determined by deducting from the gross maintainable rent (a) the amount of taxes levied by any local authority in respect of property (deduction is available even if these are to be borne by the tenant) ; and (b) *A* sum equal to 15% of gross maintainable rent.

The net maintainable rent is finally capitalized to arrive as value of net asset.. This can be done by multiplying the net maintainable rent by 12.5. If the property is constructed on leasehold land, net maintainable rent is to be multiplied by 10 when the unexpired period of lease of such land is 50 years or more and multiplied by 8 where the unexpired period of lease of such land is less than 50 years).

If a property is acquired / constructed after March 31, 1974, then the value of the house property is determined as above. Original cost of construction / acquisition *plus* cost of improvement of the house property is calculated. The higher of the above is taken as capitalised value of net maintainable rent. This exception is applicable in respect one house property. The cost of acquisition / construction (*plus* cost of improvement) does not exceed Rs. 50 lakh, if the house is situated at Bombay, Calcutta, Delhi and Madras (Rs. 25 lakh at any other place).

If unbuilt area of the plot of land on which the property is built exceeds the specified area, premium is to be added to the capitalised value determined above.

Valuation of self-occupied property - If assessee owns a house (or a part of the house), being an independent residential unit and is used by the assessee exclusively for his residential purposes throughout 12 months ending on the valuation date, valuation will be as per provisions of section 7(2).

Assessee can either take value of the house as determined above on the valuation date relevant for the current assessment year or he take value of the house, as determined above, on the first valuation date next following the date on which he became the owner or the valuation relevant for the assessment year 1971-72, whichever is later. The choice is of the assessee.

Where the house has been constructed by the assessee, he shall be deemed to have become the owner thereof on the date on which the construction of such house was completed.

Valuation of assets of business - If the assessee is carrying on a business for which accounts are maintained by him regularly, the net value of the assets of the business as a whole, having regard to the balance sheet of such business on the valuation date, is taken as value of such assets [Part D, Schedule III].

(A) The assets are valued as follows - ***Depreciable assets*** - Written down value, plus 20%***, Non-depreciable assets (other than stock-in- trade)*** - Book value, plus 20%, ***Closing stock*** - Value adopted for the purpose of income-tax, plus 20%.

(B) Then value of house property, life interest, jewellery and other assets is calculated as per other provisions of Wealth Tax Act.

Higher of A or B is taken as value of assets.

Value of interest in firm or association of persons - The net wealth of the firm on the valuation date is ascertained.. For determining the net wealth of the firm (or association), no account shall be taken of the exemptions given by section 5. The portion of the net wealth as is equal to the amount of the capital of the firm or association is allocated amongst the partners or the members in the proportion in which capital has been contributed by them.

The residue of the net wealth is allocated amongst the partners or the members in accordance with the agreement of the partnership or association of persons for the distribution of assets in the event of dissolution of the firm or association or in the absence of such agreement, in the proportion in which the partners (or members) are entitled to share profits [Part E, Schedule III]

Value of life interest **-** The value of life interest of an assessee shall be determined as per Part F, Schedule III. Average net annual income of the assessee derived from the life interest during 3 years ending on the valuation date is calculated. While computing net annual income, expenses incurred on the collection of such income (maximum of 5% of the average of annual gross income) shall be deducted. This is multiplied as per formula prescribed to arrive at value of asset.

Valuation of jewellery **-** The value of jewellery shall be estimated to be the price which it would fetch if sold in the open market on the valuation date (*i.e.*, fair market value). Where the value of jewellery does not exceed Rs. 5,00,000, a statement in Form No. O-8A is to be submitted. Where the value of the jewellery exceeds Rs. 5,00,000, a report of a registered valuer in Form No. O-8 should be submitted. The report is not binding on assessing officer (Valuation Officer) and he can determine fair market value of jewellery.

The value of jewellery determined by the Valuation Officer for any assessment year shall be taken to be the value of such jewellery for the subsequent four assessment years subject to the prescribed adjustments.

Valuation of any other asset **-** The value of any asset, other than cash (being an asset which is not covered in above paras) shall be estimated either by the Assessing Officer himself or by the Valuation Officer if reference is made to him under section 16A. In both these cases, the value shall be estimated to be the price which it would fetch if sold in the open market, on the valuation date. If the asset is not saleable in the open market, the value shall be determined in accordance with guidelines or principles specified by the Board from time to time by general or special order.

16.3 OTHER ISSUES RELATING TO WEALTH TAX

Charitable or religious trusts **-** A trust can forfeit exemption for any of the following reasons - (a) any part of the trust's property or any income of the trust, including income by way of voluntary contributions, is used for the benefit of the settlor, the trustee, their relatives etc.; or (b) any part of the income of the trust, created on or after April 1, 1962, including income by way of voluntary contributions, enures directly or indirectly, for the benefit of any of the persons referred to in section 13(3) of the Income-tax Act ; or (c) any funds of the trust are invested or deposited or any shares in a company are held by the trust in contravention of the investment pattern for trust funds laid down in section 11(5) of the Income-tax Act.

In such case, tax shall be leviable upon and recoverable from the trustee or manager in respect of the property held by him under trust at the rate of tax applicable to a resident in India.

These provisions are not applicable in the case of a scientific research association [Section 10(*21*) of the Income-tax Act] and in the case of any institution, fund or trust referred to in section 10(*22*), (*22A*), (*22B*) or (*23C*) of the Income-tax Act in specified situations [Section 21A]

Association of persons where shares of members are indeterminate/unknown - If assets chargeable to wealth-tax are held by an association of persons and the individual shares of the members in the income or assets of the association are indeterminate or unknown, wealth-tax is levied to the same extent as it would be leviable upon and recoverable from an individual who is citizen of India and resident in India [Section 21AA]

16.3.1 Return of wealth and assessment

Every person is required to file with the Wealth-tax Officer a return of net wealth in Form BA, if his net wealth or net wealth of any other person in respect of which he is assessable under the Act on the valuation date is of such an amount as to render him liable to wealth-tax. Return can be filed on or before the "due date" specified under section 139 of the Income-tax Act.

Return in response to a notice - In the case of any person who, in the opinion of Wealth-tax Officer, is assessable to tax, the Wealth-tax Officer may, before the end of the relevant assessment year, issue a notice requiring him to furnish, within 30 days from the date of service of such notice, a return of net wealth in the prescribed form.

Assessment - The assessee is required to pay the tax before filing of the return and such return is to be accompanied by the proof of such payment. Provisions of regular assessment, as applicable under Income Tax, will apply to wealth tax also.

Interest or penalty and prosecution - Interest @ 1% per month is payable for failure to pay wealth tax on due date. Penalty and prosecution provisions also apply.

QUESTION

Mr. A has the following assets on 31-3-2008:

Asset	Market value on 31-3-2008 Rs. lakhs	Loan outstanding On 31-3-2008 Rs. Lakhs (loans taken acquire the asset)	Security Given for Taking the Loan
Gold and silver	80	6	Shares
Shares	10	3	House B
Residential House A	50	4	Gold
Residential House B	42	38	Personal
Commercial House C(used for Carrying on own business)	95	5	Personal
Boat	8	12	Gold
Motor cars	11	1	Silver
Bank deposit	1	1	------
Residential House D(let out throughout The financial year 2007-08)	55	40	House D
Commercial complex (having 20 offices)	190	100	Commercial Complex

A also took a bank loan of Rs. 75,000 against the security of his car for his friend's marriage. Out of the Rs. 12 lakh loan taken by him for purchasing the boat, he utilized Rs. 1 Lakh for his foreign visit. Compute the net wealth for assessment year 2008-09

Answer

	Assets (Rs. Lakh)	**Debts owed Rs. Lakhs**
	80	**6**
Shares- not an "asset" within the meaning of section 2*(ea)*	**----**	**----**
Residential House A[exempt under Section 5*(vi)*]		**----**
Residential House B	**Gold and silver**	**38**
Commercial House C(used for Carrying on own business- Therefore it is not an "asset" within the meaning of section 2*(ea)*)	**----**	**----**
Boat	**8**	**11**
Motor cars	**11**	**1**
Bank deposit[not an asset within the meaning of section 2*(ea)*]	**----**	**---**
Residential House D(let out throughout the financial year 2005-06) –Residential house not an "asset" if let out for 300 days or more in the previous year.	**----**	**---**
Commercial complex (having 20 offices) not an "asset" within the meaning of section 2*(ea)*	**----**	**----**
Total	**141**	**56**

Net wealth = Rs 141 lakhs *minus* Rs 56 Lakhs = Rs. 85 lakhs

Mr. A owns a commercial house property which is situated at Pune. The difference between unbuilt area and specified area is 22% of the aggregate area. The property was acquired on 31-5-1988 for Rs. 12,50,000. The property is built on freehold land. How will the property be valued for wealth-tax purposes?

As the difference between unbuilt area and specified area exceeds 20% of the aggregate area, value shall be estimated by the Assessing Officer himself or by the Valuation Officer under section 16A if the reference is made to him under section 16A. In either case, the value shall be estimated to be the price which it would fetch if sold in the open market, on the valuation date. If the property is not saleable in the open market, valuation shall be as per CBDT's guidelines specified from time to time.

STUDY NOTE-17

DIFFERENT ASPECTS OF DIRECT TAX PLANNING

This Study Note includes

- **Different Aspects Of Direct Tax Planning**

INTRODUCTION

The provisions of the Income-Tax are contained in the Income-Tax Act, 1961 (the Act), which extends to whole of India and is operative from the 1st day of April, 1962(the Rules). The Act provides for determination of taxable income, tax liability, procedures for assessment, appeals, penalties, interest levies, the tax payment schedules and its determination, refunds and prosecutions.

Depending upon Government polices certain income is exempted from tax, for example SEZ (Special Economic Zone) units income, Agriculture income, etc. and deduction are also provided on fulfillment of prescribed criteria. Provisions relating to such exemptions and deduction are also contained in the Act.

Corporate form of business is much in vogue. Therefore, certain taxes specific to companies like Tax on Book profit (115JB), tax on Dividend Distributed (115O), are levied.

At times in Cross border transactions income earned get exposed to tax in India as well as in some other countries. Provisions for upholding relief from double taxation are also made in the Income Tax Act.

In respect of certain perquisites given to the employees as a group, it becomes difficult to identify income flowing from such benefits with an employee and to overcome this limitation Fringe Benefit tax (FBT) is charged on employers. The law of FBT is also contained in the Act.

The Act also lays down the powers duties of various income-tax authorities. Being revenue legislation, the act is amended once a year through union budgets and the finance bill is normally presented to the Parliament for approval around February. The Act has empowered the Central Board of Direct Taxes (CBDT) to frame the rules and these rules are implemented after necessary Gazette notifications. The CBDT also issues circulars and clarifications from time to time for implementation by the income-tax authorities by virtue of section 119, which gives such rule making powers to the CBDT. It is impracticable for the Act to provide exhaustively for everything relating to limits, conditions, procedures, forms and various other aspects. Therefore this power has been delegated to CBDT and thus periodical changes and modification by an executive authority is facilitated. The power to frame rules is vested with the Board u/s 295 of the Act and the word 'prescribed' used in section 2(33) means what is prescribed by rules made under the Act.

The Income-Tax Act gives definitions of the various terms expressions used in the Act. Unless the context otherwise requires, these definition should be applied. The words 'means' 'includes' and 'means and includes' are used in these definitions and the significance of these terms needs to be understood. When a definition uses the word 'means' the definition is self-explanatory, restrictive and in a sense exhaustive. It implies that the term or expression so defined

means only as to what is defines as and nothing else. For example, the terms 'agricultural income' 'assessment year' 'capital asset', are exhaustively defined. When the legislature wants to widen the scope of a term or expression and where an exhaustive definition cannot be provided, it uses the word 'includes' in the definition. Generally an inclusive definition provides an illustrative meaning and the definition could include what is not specifically mentioned in the definition so long as the stipulated criteria are satisfied. To illustrate refer to the definitions of 'income', 'person', 'transfer' in the Act. When the legislature intends to define a term or expression to mean something and also intends to specify certain items to be included, other the words ' means' as well as ' includes' are used. Such definition is not only exhaustive but also illustrative in specifying what is intended to be included. Sometimes specific items are included in an exhaustive definition in order to avoid ambiguity and to provide clarity. Please refer to definitions of 'assessee', 'Indian company','recognised provident fund', under the Act.

Further any decision given by the Supreme Court also becomes a law on the subject and will be binding on all the courts, tribunals, income-tax authorities as well as the taxpayers. In case of apparent contradictions in the Supreme Court rulings, the following rules may have to be followed:-

1. The decision of the larger bench would prevail.
2. The principle of the later decision shall prevail, where the decisions are by equal number if judges.

Decisions given by High Courts are binding on all taxpayers and It authorities, which fall under its jurisdiction till it is overruled by higher authority.

RATES OF TAX

1. Tax Rates for Individuals/HUF/AOP/BOI :

Tax Rates for Individuals/HUF/AOP/BOI : For A.Y. 2007-08	
Income	Rate (%)
Up to 100000*	NIL
100001 to 150000	10
150001 to 250000	20
Above 250000	30

* Threshold limit for resident women assessees below 65 years of age and resident individuals of 65 years and above to be increased to Rs. 1,35,000/- and Rs. 1,85,000/- respectively.

Surcharge @ 10% applicable if total income exceeds Rs. 10,00,000/-.

Marginal relief would be provided to ensure that the additional income tax payable including surcharge, on the excess of income over Rs. 10,00,000/- is limited to the amount by which the income is more than Rs. 10,00,000/-.

Education Cess @ 2% leviable on tax plus surcharge.

For A.Y. 2008-09

For A.Y. 2008-09

Income	Rate (%)
Up to 110000*	NIL
110001 to 150000	10
150001 to 250000	20
Above 250000	30

* Threshold limit for resident women assessees below 65 years of age and resident individuals of 65 years and above to be increased to Rs. 1,45,000/- and Rs. 1,95,000/- respectively.

Surcharge @ 10% applicable if total income exceeds Rs. 10,00,000/-.

Marginal relief would be provided to ensure that the additional income tax payable including surcharge, on the excess of income over Rs. 10,00,000/- is limited to the amount by which the income is more than Rs. 10,00,000/-.

Education Cess @ 2% and Secondary and Higher education cess @ 1% leviable on tax plus surcharge.

2. Tax Rates for Firms :

Asst.Year	Tax %	Surcharge %	Education Cess/Secondary and Higher Education cess %	Total %
2007-08	30	10	2	33.66
2008-09	30	10*	3	33.99

3. Tax Rates for Domestic Companies :

Assessment Year	Tax %	Surcharge %	Education Cess/Secondary and Higher Education cess %	Total %
2007-08	30	10	2	33.66
2008-09	30	10*	3	33.99

* No surcharge will be levied on companies having total income of not more than Rs. 1 crore.

4. Dividend Distribution Tax :

Asst.Year	Tax %	Surcharge %	Education Cess/Secondary and Higher Education cess %	Total %
2007-08	12.5	10	2	14.025
2008-09	15	10	3	16.995

5. Income Distribution Tax for Mutual Fund :

	A.Y. 2007-08		A.Y. 2008-09	
Rate	If Distributed to Individual/ HUF	If Distributed to any other person	If Distributed to Individual/ HUF	If Distributed to any other person
Tax %	12.5	20	12.5	20
Surcharge %	10	10	10	10
Edn.Cess %	2	2	3	3
Total %	14.025	22.44	14.1625	22.66

Note: From A.Y. 2008-09 income distributed by a money market mutual fund or liquid fund will be taxed @25% plus surcharge and education / Higher secondary cess.

6. Co-operative society :

Income	Rate %	Education Cess/Secondary and Higher Education cess %	Total %
Up to 10000	10	3	10.3
10001 to 20000	20	3	20.6
20001 and above	30	3	30.9

7. Special Rates :

1. Long Term Capital Gains

a. On Equity shares and units

Long term capital gain arising on transfer of equity shares in a recognized stock exchange in India or units of an equity oriented Mutual Fund (if 65% of total proceeds of the fund are invested in equity shares), and on which Securities Transaction tax is chargeable.

For All Assesses	Nil – Exempt under section 10(38)

b. On other assets and equity shares, units except falling in (a) above

Income Tax on Long Term Capital Gains	
Resident Individual or HUF	20%
Domestic Companies	20%
Non-residents	20%
NRIs (for gains u/s 115E)	10%
Any other case	20%

Notes:

If tax payable in case of Long Term Capital Assets, being listed securities or units or zero coupon bond, exceeds 10% of Capital gains before indexation, then such excess may be ignored.

Surcharge at the rates applicable to the assessee. Education cess @2% and Secondary and Higher education cess @ 1% (from A.Y. 2008-09) applicable on tax inclusive of surcharge.

In case of resident individual and HUF, where tax liability arises only because of the inclusion of long term capital gains tax to be levied at 20% or 10% as the case may be, on the excess over the minimum exemption limit.

In case of resident individual and HUF, relief from LTCG is available in respect of the amount by which the Taxable Income other than LTCG falls short of Basic Exemption Limit.

No deduction under Chapter VI-A (80C to 80U)

2. *Short Term Capital Gains*

a. On Equity shares and units

Short term capital gain arising on transfer of equity shares on recognized stock exchange in India or units of an equity oriented Mutual Fund (if 65% of total proceeds of the fund are invested in equity shares), and on which Securities Transaction Tax is chargeable

For All Assessees	10% plus surcharge, if applicable plus Education Cess & Secondary and Higher education cess.

Notes:

1. No Deduction under Chapter VI-A (80C to 80U)
2. In case resident individual and HUF, relief from STCG available in respect of the amount by which the taxable income other than STCG, falls short of Basic Exemption Limit

b. On Short Term Capital Gain Other than in (a) above

8. Advance Tax

Advance Tax Obligation (If tax payable exceeds Rs. 5,000)		
Due Date of Installment payable on or before	**Amount Payable as a % of Tax**	
	For Companies*	**For Other Assessees**
15th June	15%	–
15th September	45%	30%
15th December	75%	60%
15th March	Balance	Balance

Advance Tax Obligation (In respect of Fringe Benefit Tax payable)		
Due Date of Installment payable on or before	**Amt. Payable as a % of Tax**	
	For Companies*	**For Other Assessees**
15th June	15%	–
15th September	45%	30%
15th December	75%	60%
15th March	Balance	Balance

MARGINAL RELIEF

In case of such individuals / HUFs / AOPs / BOIs having a total income exceeding Rs.10,00,000, the additional amount of income-tax payable (together with surcharge) on the excess of income over Rs.10,00,000 should not be more than the amount of income exceeding Rs.10,00,000. This is called 'marginal relief'.

Illustration : Suppose Mr. X has total income of Rs.10 lakhs.

Tax on this income = Rs.0 + 10% of Rs.50,000 + 20% of Rs.1,00,000 + 30% of Rs.7,50,000 = Rs.2,50,000.

Surcharge is not attracted on this tax since the total income does not exceed Rs.10 lakhs.

However, if his total income is Rs.10,30,000, then

Tax on this income = Rs.0 + 10% of Rs.50,000 + 20% of Rs.100,000 + 30% of Rs.780,000 = Rs.2,59,000.

Add: Surcharge = Rs 25,900 [10% of Rs.2,59,000]

Rs 2,84,900

On comparing the two situations, it is seen that for Rs.30,000 [i.e. Rs.10,30,000 – Rs.10,00,000] increase in the total income, the tax liability including surcharge has increased by Rs.34,900 [i.e. Rs.2,84,900 – Rs.2,50,000].

Marginal relief = Rs.34,900 – Rs.30,000 = Rs.4,900

Tax payable = Rs.2,50,000 + Rs.30,000 = Rs.2,80,000

Certain Important Concepts

Understanding of basic concepts is necessary for tax planning. Important concepts are as under:

1."person" includes—

(*i*) An individual,

(*ii*) A Hindu undivided family,

(*iii*) A company,

(*iv*) A firm,

(*v*) An association of persons or a body of individuals, whether incorporated or not,

(vi) A local authority, and

(vii) Every artificial juridical person, not falling within any of the preceding sub-clauses

Assessment Year

"Assessment year" means the period of twelve months commencing on the 1st day of April every year

Previous Year

For the purposes of this Act, "previous year" means the financial year immediately preceding the assessment year:

Provided that, in the case of a business or profession newly set up, or a source of income newly coming into existence, in the said financial year, the previous year shall be the period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly comes into existence and ending with the said financial year.

Income

"Income" includes—

(*i*) Profits and gains;

(*ii*) Dividend;

(*iia*) Voluntary contributions received by a trust created wholly or partly for charitable or religious purposes or by an institution established wholly or partly for such purposes [or by an association or institution referred to in clause (*21*) or clause (*23*), or by a fund or trust or institution referred to in sub-clause (*iv*) or sub-clause (*v*) [*or by any university or other educational institution referred to in sub-clause (*iiia*d*) or sub-clause (*vi*) or by any hospital or other institution referred to in sub-clause (*iiia*e*) or sub-clause (*via*)*] of clause (*23C*) of section 10].

(*iii*) The value of any perquisite or profit in lieu of salary taxable under clauses (*2*) and (*3*) of section 17 ;

(*iiia*) Any special allowance or benefit, other than perquisite included under sub-clause Specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit;

(*iiib*) Any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living;

(*iv*) 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 a 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;

(*iva*) The value of any benefit or perquisite, whether convertible into money or not, obtained by any representative assessee mentioned in clause

(*ivb*) of sub-section (1) of section 160 or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee (such person being hereafter in this sub-clause referred to as the "beneficiary") and any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary.

(*v*) Any sum chargeable to income-tax under clauses (*ii*) and (*iii*) of section 28 e.g. any compensation or income of a trade association from specific services or section 41 or section 59 e.g.; "profits and gains of business or profession.

(*va*) Any sum chargeable to income-tax under clause (*iiia*) of section 28 ; i.e.; profit on sale of License under Import and Export (Control) Act, 1947

(*vb*) Any sum chargeable to income-tax under clause (*iiib*) of section 28 ; i.e.; cash received or receivable by any person against Export

(*vc*) Any sum chargeable to income-tax under clause (*iiic*) of section 28 ; i.e. any duty re-paid or repayable against export

(*vd*) the value of any benefit or perquisite taxable under clause (*iv*) of section 28 i.e. any benefit or perquisite, whether convertible into money or not

(*ve*) any sum chargeable to income-tax under clause (*v*) of section 28 ; e.g. any interest, salary, bonus, commission or remuneration received by partner

(*vi*) any capital gains chargeable under section 45 i.e.; profits or gains from transfer of capital assets.

(*vii*) 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 or any surplus taken to be such profits and gains by virtue of provisions contained in the First Schedule ;

(viia) the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members;

(*ix*) any winnings 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.

(*x*) 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 other fund for the welfare of such employees ;

(*xi*) any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

(*xii*) any sum referred to in [clause (*va*)] of section 28; e.g.; any sum received or receivable for not carrying out any business

activity or not sharing any patent, copyrights, trade-mark, licence, franchise or carry on any similar business.

(*xiii*) any sum referred to in clause (*v*) or (vi) of sub-section (2) of section 56 i.e. gift of money

Definition of 'income' is inclusive i.e. whatever is stated in the definition is income and in addition, what is normally considered as income is also income for the purpose of taxation.

Charge of income-tax [section 4]

The income-tax takes special cognizance of the following

1. The period of stay in the case of an individual and the control and management of affairs in the case of entity other than individual.
2. The income-tax liability under the Indian tax laws is computed not only based upon income actually received but also those incomes that are constructively received. As a corollary to the above, income once taxed on accrual basis, will not be taxed again on receipt.

3. The income-tax liability under the Indian tax laws is worked out based on the rates of income-tax announced in each year's Finance Act.

4. The income-tax liability is not related to the accounting treatment given to the income in the Balance sheet of the assessee. To illustrate, if an income is included in the Balance Sheet prepared in India it is not necessary to tax it in the same year as a constructive income.

5. The income-tax is collected where tax is payable, either by way of deduction at the time of payment or as advance tax in periodic installments.

6. The Act recognizes the distinction between earning of income and its apportionment and the demarcation between a capital receipt and a revenue receipt.

7. The word 'income' has not been exhaustively defined by the Indian tax Laws and what is included under the definition clause is only illustrative and not exhaustive.

8. If a person is resident in a previous year in respect of any source of income, he shall be deemed to be resident in respect of each of his other sources of income.

9. Indian income-tax laws are applicable irrespective of the citizenship.

Scheme of Taxation

Every person, whose total income of the previous year exceeds the maximum amount, which is not chargeable to income tax, is an assessee and chargeable to income tax at the rate(s) prescribed in the Finance Act for the assessment year. However, his total income shall be determined on the basis of his residential status in India.

RESIDENTIAL STATUS

In determining the total income, it becomes important to decide on the residential status of the taxpayer, as the total income is different according to the residential status. The incidence of tax shall also vary according to the residential status

For all purposes of income-tax, taxpayers are classified into three broad categories on the basis of their residential status. Viz

(1) Resident and ordinarily resident

(2) Resident but not ordinarily resident

(3) Non-resident

The residential status of an assessee must be ascertained with reference to each previous year. A person who is resident and ordinarily resident in one year may become non-resident or resident but not ordinarily resident in another year or vice versa. The provisions for determining the residential status of assessees are:

(1) Residential status of Individuals:

a) Resident : Under section 6(1), an individual is said to be resident in India in any previous year, if he satisfies any one of the following conditions:

(i) He has been in India during the previous year for a total period of 182 days or more,

OR

(ii) He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the previous year.

If the individual satisfies any one of the conditions mentioned above, he is a resident. If both the above conditions are not satisfied, the individual is a non-resident.

Note:

(a) The term "stay in India" includes stay in the territorial waters of India (i.e. 12 nautical miles into the sea from the Indian coastline). Even the stay in a ship or boat moored in the territorial waters of India would be sufficient to make the individual resident in India.

(b) It is not necessary that the period of stay must be continuous or active nor is it essential that the stay should be at the usual place of residence, business or employment of the individual.

(c) For the purpose of counting the number of days stayed in India, both the date of departure as well as the date of arrival are considered to be in India.

(d) The residence of an individual for income-tax purpose has nothing to do with citizenship, place of birth or domicile. An individual can, therefore, be resident in more countries than one even though he can have only one domicile.

Exceptions:

The following categories of individuals will be treated as residents only if the period of their stay during the relevant previous year amounts to al least 182 days. In other words even if such persons were in India for 365 days during the 4 preceding years and 60 days in the relevant previous year, they will not be treated as resident.

(1) Indian citizens, who leave India in any previous year as a member of the crew of an Indian ship or for purposes of employment outside India, or

(2) Indian citizen or person of Indian origin* engaged outside India in an employment or a business or profession or in any other vocation, who comes on a visit to India in any previous year

A person is said to be of Indian origin if he or either of his parents or either of his grandparents were born in undivided India.

b) Not-ordinarily resident : Only individuals and HUF can be resident but not ordinarily resident in India. All other classes of assessees can be either a resident or non-resident. A not-ordinarily resident person is one who satisfies any one of the conditions specified under section 6(6).

(i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year,

OR

(ii) If such individual has during the 7 previous years proceeding the relevant previous year been in India for a period of 729 days or less.

c) An individual is classified as non-resident if:

1) He has not stayed in India for more than 181 days in the previous year.

2) He has not stayed in India for more than ***59*** days during the previous year and has stayed for less than ***365*** days during the four previous years preceding the previous year.

3) He has not been resident in India in nine out of the 10 previous years proceeding the previous year.

4) He has stayed for less than 730 days during the 7 previous years proceeding the previous year.

RESIDENTIAL STATUS OF HINDU UNDIVIDED FAMILY – [Sec. 6(2)]

A Hindu undivided family (HUF) is resident in India if control and management of its affairs is, wholly or partly, situated in India. A HUF is non-resident in India if control and management of its affairs is wholly situated outside India.

A resident HUF is ordinarily resident in India if karta or manager of the family satisfies the following two additional conditions-

(i) he has been resident in India in at least 9 out of 10 previous years (according to basic conditions mentioned in case of individuals) preceding the relevant previous year; and

(ii) he has been present in India for a period of 730 days or more during 7 years preceding the previous year.

The HUF will be resident but not ordinarily resident in India if the karta or the manager of the family of a resident HUF does not satisfy the above two additional conditions.

RESIDENTIAL STATUS OF A COMPANY- [Sec. 6(3)]

An Indian company is always resident in India. A foreign company is resident in India only if, during the previous year, control and management of its affairs is situated wholly in India.

A foreign company is treated as non-resident if, either wholly or partly situated out of India. "Control and management" refers to "hand and brain" which directs affairs of the policy, finance, disposal of profits and other vital things concerning the management of the company.

RESIDENTIAL STATUS OF FIRM AND ASSOCIATION OF PERSONS –

[Sec. 6(4)]

A partnership firm or an association of persons is said to be resident in India if control and management of their affairs are wholly or partly situated within India during the relevant previous year. If control and management is situated wholly outside India, such firm or association of persons will be treated as non-resident in India. In case of a firm the control and management is vested in partner whereas in case of association of persons it is vested in the principal officer. Usually control and management is situated at a place where the hand, the seat and the directing powers are situated.

RESIDENTIAL STATUS OF "EVERY OTHER PERSON" – [Sec. 6(4)]

Every other person is resident in India if control and management of his affairs is wholly or partly situated within India during the relevant previous year. Every other person will be non-resident in India if control and management of its affairs is wholly situated outside India.

STATUS AND INCIDENCE OF INCOME-TAX

The incidence of tax on a tax-payer depends on his residential status as well as on the place and time of accrual or receipt of income. A suitable table is given below :

Particulars of income Tax incidence in case of –		Resident	Resident but not ordinarily resident	Non-resident
a.	Income received in India whether accrued in India or outside India	Yes	Yes	Yes
b.	Income deemed to be received in India whether accrued in India or outside India.	Yes	Yes	Yes
c.	Income accruing or arising in India whether received in India or outside India.	Yes	Yes	Yes
d.	Income deemed to accrue or arise in India, whether received in India or outside India.	Yes	Yes	Yes
e.	Income received and accrued outside India from a business controlled in profession set up in India	Yes	Yes	No
f.	Income received and accrued outside India from a business controlled from outside India or profession set up outside India.	Yes	No	No
g.	Income earned and received outside India but later on remitted to India.	No	No	No
	Total	**a to f**	**a to e**	**a to d**

Important Paragraphs

The previous year in the following cases shall be as spelt out against each category of income or the assessee as given hereunder:

Category of Income:

(a) Unexplained cash credits – the year of credit (section 68).

(b) Unexplained investments – the year of investment (section 69).

(c) Unexplained money, etc – the year in which the assessee was found to be the owner (section 69A).

(d) Understated investment – the year in which such understatement was found (section 69B).

(e) Unexplained expenditure – the year which such expenditure was incurred (section 69C).

(f) Amount borrowed or repaid other than through an account payee cheque – the year of

borrowal or repayment, whichever is earlier. The amount repaid shall include the amount of interest paid on the amount borrowed. In case the person is assessed to tax on the amount borrowed, he shall be liable to be assessed again in respect of repayment.

Category of assesses:

(a) Non-resident shipping business – will be charged to tax in the year in which the ship is allowed to leave the Indian port (section 172).

(b) Person leaving India – In the year of departure (section 174).

(c) Association of persons or Body of individuals or artificial judicial person formed for assessee particular event or purpose – in the year in which dissolution takes place (section 174A).

(d) Person trying to alienate his assets with a view to avoid tax – the period commencing from the expiry of the previous till the date when the Assessing Officer commences proceedings (section 175).

(e) Discontinued business – the period commencing from the expiry of the previous year till the date of discontinuance (section 176).

'Average rate of tax' is defined to mean the rate arrived at by dividing the amount of tax calculated on the total income by such total income. This definition becomes relevant in view of rebate u/s 110 in the assessment of member of an AOP.

'Maximum marginal rate' is defined to mean the rate of income-tax (including surcharge on tax, if any) applicable in relation to the highest slab of income in case of an individual, AOP or BOP as the case may be as prescribed in the Finance Act of the relevant year. This would mean that there will not be any exemption limit or slab rate in such cases.

'Gross total income' means total income computed in accordance with the provisions of the Income-tax Act before making any deductions under chapter VI-A and total income means the total income referred to in section 5; computed in the manner laid down in the Income-tax Act.

Scope of total income.

Section 5 of the Act scope of income, for the purpose of taxation, depends upon location where the income arises, accrues or is received and his residential status. The scope is as under:

Location	Resident		Non-Resident
	and Ordinarily Resident	But not Ordinarily Resident	
Income is received or is deemed to be received in India	Taxable	Taxable	Taxable
Income accrues or arises or is deemed to accrue or arise to him in India	Taxable	Taxable	Taxable
Income accrues or arises to him outside India	Taxable	Not Taxable (Refer Note)	Not Taxable

Note : For a person 'not ordinarily resident in India, the income which accrues or arises to him outside India shall not taxable in India unless it is derived from a business controlled in or a profession set up in India

Notes:

1.—Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India

2.—Income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India.

In considering what is total income under section 5, one has to exclude such income, as is excluded from the scope of total income by reason of any other provision of the Income-tax Act and not that the other provisions of the Income-tax Act override the provisions of section 5 - CIT v. F.Y. Khambaty 159 ITR 203 (Bom.).

The burden of proving that an amount was taxable because it was received in the year of account lay upon the department - CIT v. Bikaner Trading Co. Ltd. 78 ITR 12 (SC).

Constructive Income:

Income is taxed at the point of receipt under certain circumstances. The following incomes shall be deemed to be received in the previous year:

1. Annual accretion in the previous year to the balance to the credit of an employee participating in a recognized provident fund to the extent in the Act, and

2. The transferred balance in a recognized provident fund as provided in the Act.

3. In the case of dividend income, it will be taken as an income in the previous year in which it is declared / distributed / paid as the case may be. In the case of interim dividend, it will be taken as income in the previous year in which it is unconditionally made available. However, under section 10(34) any corporate dividend referred to in section 115O is exempt from tax.

4. Salaries are normally taxed based on the situs of service. If the services were outside India, it is not normally taxed.

5. In case of assessee liaison or branch office of a non-resident engaged in procurement and export of Indian goods, the income earned is exempt.

6. In the case of assessee non-resident engaged in media publishing, news gathering or shooting of films in India no income is deemed to accrue in India.

The tax incidence in the case of varying residential status of the assessee is explained hereunder:-

	Resident	Not Ordinarily Resident	Non-resident
Business Income (Indian operations only)	Taxable	Taxable	Taxable
Purchase of goods for re-export	Taxable	Taxable	Not Taxable
Collection / transmission of news & services for media	Taxable	Taxable	Not Taxable
Shooting any cinematography in India	Taxable	Taxable	Not Taxable
Salaries in India	Taxable	Taxable	Taxable
Dividend paid by any Indian company outside India	Taxable	Taxable	Taxable
	However, Corporate Dividends are Exempt under section 10(34)		
Interest Income	Taxable	Taxable where the entire income is earned in India	Taxable where the entire income is earned in India
Royalties	Taxable	Taxable where used for earning income in India	Taxable where used for earning income in India
Fees for Technical services	Taxable	Taxable where used for earning income in India	Taxable where used for earning income in India
Pension paid outside	----------	----------	Not taxable based on contract of service

Agricultural Income and Aggregation of Incomes

Article 270 of the Constitution of India empowers Government of India to collect tax on income other than agricultural income. Agricultural income has been placed in the State list and as such Parliament cannot levy tax on agricultural income.

According to sec. 2(1A), agricultural income means –

a) any rent or revenue derived from land which is situated in India and is used for agricultural purposes.

b) 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 ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market; or

   iii) the sale by a cultivator or receiver of rent in kind of the produce raised or received by him, in respect of which no process has been raised or received by him, in respect of which no process has been performed other than a process of the nature described in para (ii) of the sub-clause:

c) any income derived from any building owned and occupied by the receiver of rent or revenue of any such land provided the following conditions are satisfied-

   i) the building should be on or in the immediate vicinity of land and is used for agricultural purposes;

   ii) the cultivator or receiver of rent-in-kind uses the building as a dwelling house or a store house; and

   iii) the land is assessed to land revenue or local rate or the land is situated within the jurisdiction of municipality / cantonment having a population of not less than 10,000 persons or within distance of not more than 8 k.m.

This definition is very wide and covers the income of not only the cultivators but also the land holders who might have rented out the lands. Agricultural income may be received in cash or in kind. Agricultural income may arise in any one of the following three ways:-

(1) It may be rent or revenue derived from land situated in India and used for agricultural purposes.

(2) It may be income derived from such land through agriculture or the performance of a process ordinarily employed by a cultivator or receiver of rent in kind to render the produce fit to be taken to the market or through the sale of such agricultural produce in the market.

(3) Lastly, agricultural income may be derived from any farm building required for agricultural operations.

Explanation regarding gains arising on the transfer of urban agricultural land –

The capital gains arising from the transfer of such urban agricultural land would not be treated as agricultural income under section 10 but will be taxable under section 45. Urban area means any area which is within the jurisdiction of a municipality or cantonment board having a population of atleast 10,000 and any area outside the limits of such municipality or

cantonment board but within a maximum distance of 8 km. from such limits as notified by the Central Government.

Example: Suppose Milind sells agricultural land situated in New Delhi for Rs. 10 lakhs and makes a surplus of Rs.8 lakhs over its cost of acquisition.

This surplus will not constitute agricultural income exempt under section 10(1) and will be taxable. It will be taxable as capital gain under section 45, if held as a capital asset and as business income under section 28, if held as stock in trade.

If land sold was used for more than two years for 'agriculture, by the seller or an exemption u / s 54B can be claimed by reinvesting the proceeds in another agricultural land within the stipulated period and subject to the satisfying the requirements of that section.

Agriculture Income and it's Taxability :

Agricultural income [Section 10(1)] –

(i) Section 10(1) provides that agricultural income is not to be included in the total income of the assessee. The reason for totally exempting agricultural income from the scope of central income tax is that under the Constitution, the Parliament has no power to levy a tax on agricultural income.

(ii) Indirect way of taxing agricultural income - However, since 1973, a method has been found out to levy tax on agricultural income in an indirect way. This concept is known as partial integration of taxes. It is applicable to individuals, HUF, unregistered firms, AOP, BOI and artificial persons. Two conditions which need to be satisfied for partial integration are:

1. The net agricultural income should exceed Rs.5,000 p.a., and

2. Non-agricultural income should exceed the maximum amount not chargeable to tax. (i.e. Rs.1,95,000 for senior citizens, Rs.1,45,000 for women assessees below 65 years of age, Rs.1,10,000 for all other individuals A.Y. 2008-09.)

   It may be noted that aggregation provisions do not apply to company; firm assessed as such (FAS), co-operative society and local authority. The object of aggregating the net agricultural income with non-agricultural income is to tax the non-agricultural income at higher rates.

Exemption for Compulsory Acquisition of Agricultural Land

Under Section 10 (*37*) exemption is provided for in the case of an individual or a Hindu undivided family, any income chargeable under the head "Capital gains" arising from the transfer of agricultural land, where—

(*i*) such land is situate in any area referred to in item (*a*) or item (*b*) of sub-clause (*iii*) of clause (*14*) of section 2;

(*ii*) such land, during the period of two years immediately preceding the date of transfer, was being used for agricultural purposes by such Hindu undivided family or individual or a parent of his;

(*iii*) such transfer is by way of compulsory acquisition under any law, or a transfer the consideration for which is determined or approved by the Central Government or the Reserve Bank of India;

(*iv*) such income has arisen from the compensation or consideration for such transfer received by such assessee on or after the 1st day of April, 2004.

Tax calculation in such cases is as follows:

Step 1: Add non-agricultural income with net agricultural income. Compute tax on the aggregate amount.

Step 2: Add net agricultural income and the maximum exemption limit available to the assessee (i.e. Rs.1,10,000 / Rs.1,45,000 / Rs.1,95,000). Compute tax on the aggregate amount.

Step 3: Deduct the amount of income tax calculated in step 2 from the income tax calculated in step 1 i.e. Step 1 – Step 2.

Step 4: Deduct rebate u / s 88E from the amount of tax obtained in step 3.

Step 5: Add surcharge, if applicable, to the amount obtained in step 4 above.

Step 6: The sum so arrived at shall be increased by education & higher secondary cess @3%.

Apportionment in certain cases - Where the agricultural produce like tea, cotton, tobacco, sugarcane etc. are subjected to a manufacturing process and the manufactured product is sold, the profit on such sales will consist of agricultural income as well as business income. That portion of the profit representing agricultural income will be exempted. For this purpose, the Income-tax Rules, 1962 provides the basis of apportionment.

(a) Rule 7 - Income from growing and manufacturing of any product other than tea - Where income is partially agricultural income and partially income chargeable to income-tax under the head 'profits and gains of business', the market value of any agricultural produce which has been raised by the assessee or received by him as rent in kind and which has been utilised as raw material in such business or the sale receipts of which are included in the accounts of the business shall be deducted. No further deduction shall be made in

respect of any expenditure incurred by the assessee as a cultivator or receiver of rent in kind.

Determination of market value - There are two possibilities:

(a) The agricultural produce is capable of being sold in the market either in its raw stage or

after application of any ordinary process to make it fit to be taken to the market. In such a case, the value calculated at the average price at which it has been so sold during the relevant previous year will be the market value.

(b) It is possible that the agricultural produce is not capable of being ordinarily sold in the market in its raw form or after application of any ordinary process. In such case the market value will be the total of the following:—

(i) The expenses of cultivation;

(ii) The land revenue or rent paid for the area in which it was grown; and

(iii) Such amount as the Assessing Officer finds having regard to the circumstances in each case to represent at reasonable profit.

Example :

Mr. B grows sugarcane and uses the same for the purpose of manufacturing sugar in his factory. 30% of sugarcane produce is sold for Rs.10 lacs, and the cost of cultivation of such sugarcane is Rs.5 lacs. The cost of cultivation of the balance sugarcane (70%) is Rs.14 lacs and the market value of the same is Rs.22 lacs. After incurring Rs.1.5 lacs in the manufacturing process on the balance sugarcane, the sugar was sold for Rs.25 lacs. Compute B's business income and agricultural income.

Solution

Income from sale of sugarcane gives rise to agricultural income and from sale of sugar gives rise to business income.

Business income = Sales – Market value of 70% of sugarcane produce – Manufacturing expenses

= Rs.25 lacs – Rs.22 lacs - Rs.1.5 lacs

= Rs.1.5 lacs.

Agricultural income = Market value of sugarcane produce – Cost of cultivation

= [Rs10 lacs + Rs.22 lacs] – [Rs.5 lacs + Rs.14 lacs]

= Rs.32 lacs – Rs.19 lacs

= Rs.13 lacs.

(b) Rule 7A – Income from growing and manufacturing of rubber – This rule is applicable when income derived from the sale of latex or cenex or latex based crepes or brown crepes manufactured from field latex or coagulum obtained from rubber plants grown by the seller in India. In such cases 35% profits on sale is taxable as business income under the head profits and gains from business or profession, and the balance 65% is agricultural income and is exempt.

Example :

Mr. C manufactures latex from the rubber plants grown by him in India. These are then sold in the market for Rs.30 lacs. The cost of growing rubber plants is Rs.10 lacs and that of manufacturing latex is Rs.8 lacs. Compute his total income.

Solution

The total income of Mr. C comprises of agricultural income and business income.

Total profits from the sale of latex = Rs.30 lacs – Rs.10 lacs – Rs.8 lacs.

= Rs.12 lacs.

Agricultural income = 65% of Rs.12 lacs. = Rs.7.8 lacs

Business income = 35% of Rs.12 lacs. = Rs.4.2 lacs

(c) Rule 7B – Income from growing and manufacturing of coffee – (a) In case of income derived from the sale of coffee grown and cured by the seller in India, 25% profits on sale is taxable as business income under the head "Profits and gains from business or profession", and the balance 75% is agricultural income and is exempt. (b) In case of income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India, with or without mixing chicory or other flavouring ingredients, 40% profits on sale is taxable as business income under the head "Profits and gains from business or profession", and the balance 60% is agricultural income and is exempt.

(d) Rule 8 - Income from growing and manufacturing of tea - This rule applies only in cases where the assessee himself grows tea leaves and manufactures tea in India. In such cases 40% profits on sale is taxable as business income under the head "Profits and gains from business or profession", and the balance 60% is agricultural income and is exempt.

Computation Logic

Step No.	Particulars
Step 1	Determine the residential status.
Step 2	Include the income covered in the scope based on Residential status
Step 3	Classify the income on Following basis (A) Income from salaries (salaries plus bonus plus commission plus taxable allowances plus taxable perquisites less deductions u/s 16). (B) Income from house property [Net annual value of the property less deductions u/s 24 (1)]. (C) Income from business profession (Net profit as per Profit & Loss account plus adjustments required as per the Act). (D) Income from capital gains (short term and long term) (capital gains less exemptions u/s 54, 54B, 54D etc.) (E) Income from other sources (Gross income less deductions) (F) Compute income to be clubbed e.g. minor children, spouse, etc. (G) Income Exempt from Tax
Step 4	Aggregate the income to arrive at gross total income for the previous year.
Step 5	Arrive at Gross income after adjusting brought forward loss/set-offs.
Step 6	Compute Total Income after adjusting deductions as provided in Chapter VI-A of the Act.
Step 7	Round off the amount arrived at as above to the nearest multiple of ten rupees (section 288A)
Step 8	Add net agricultural income for rate purposes.
Step 9	Apply the rates of tax prescribed in the relevant Finance Act.
Step 10	Round off the tax amount to the nearest ten rupees (section 288B)
Step 11	Compute tax liability by including surcharge, if applicable, and education cess and higher secondary education cess as per the Finance Act.
Step 12	Provide for relief u/s 86, 89 to 91 of the Act.
Step 13	Provide tax credits for advance tax/tax collected at source of payment including those in respect of income clubbed.
Step 14	Compute interest payable for belated tax payments.
Step 15	Provide for self assessment tax paid.
Step 16	Calculate tax payable/refund due.

TAX PLANNING VS. TAX EVASION

The word 'tax planning' connotes the exercise carried out by the taxpayer to meet his tax obligations in proper, systematic and orderly manner availing all permissible exemptions, deductions and reliefs available under the statute as may be applicable to his case. To illustrate, assessee software company setting up assessee software technology park in assessee notified area to avail benefits of section 10A of the Act is assessee legally allowable course. Planning does not necessarily mean reduction in tax liability but is also aimed at avoiding controversies and consequential litigations.

Every taxpayer is expected to voluntarily make disclosures of his incomes and tax liabilities through legal compliance. When a tax payer deliberately or consciously do not furnish material particulars or furnishes inaccurate or false particulars or defrauds the State by violating any of the legal provisions, it shall be termed as 'tax evasion'. It is also illegal, but also unethical and immoral. Inflation of expenditure, suppuration of income, recording of fictitious transactions, claiming deductions wrongly are few examples.

Benjamin Franklin is credited with this classical statement: There are two certainties in this world – death and taxes. This makes all tax payers in general, and the companies in particular, realize the bitterness or hardship of taxes. Three methods of saving taxes have been developed in most countries of the world in the past few decades: tax evasion, tax avoidance and tax planning. A great deal of confusion prevails in corporate sector about correct connotations of these terms. Hence, we shall attempt to explain these terms to show tax planning is absolutely legal. The expression 'Tax Evasion' means illegally hiding income or concealing the particulars of income or concealing the particular source or sources of income or in manipulating the accounts so as to inflate the expenditure and other outgoings with a view to illegally reduce the burden of taxation. Hence, tax evasion is illegal and unethical. It is uneconomical as well. It deserves to be deprecated not only by the Government but by the companies as well. The next expression is 'Tax avoidance' which is assessee art of dodging taxes without breaking the law. In my opinion, tax avoidance means traveling within framework of the law or acting as per language of the law only in form, but murdering the very spirit of the law and defeating the purpose of the particular legal enactment. If, by adopting an artifice or device against the intension of the legislature but apparently on the face of it acting within the framework of the law, a company is able to dodge income tax, it would be a clear case of tax avoidance. In contrast, 'Tax Planning' takes maximum advantages of the exemptions, deductions, rebates, reliefs, and other tax concessions allowed by taxation statutes, leading to the reduction of the tax liability of the tax payer. Tax planning has been contrasted with the expression tax avoidance and has the legal sanction of the Supreme Court as well. In recent years the sentiments in favor of tax avoidance have changed and the courts view tax avoidance with displeasure. For example, Lord Summer in IRC Vs Fisher's Executors ac 395, 412 had earlier as per the ratio of Westminister's case said:

"My Lords, the highest authorities have always recognized that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown, so far as he can do so with the law, and that he may legitimately claim the advantage of any express terms or any omissions

that he could find in this favor in taxing Acts. In so doing, he neither comes under liability nor incurs blame."

The significance of Ramsay as assessee turning point in the interpretation of tax laws in England and the departure from the principle of Westminister's case were explained in TRC Vs. Burmah Oil Co. Ltd., STC 30 where Lord Diplok said:

"It would be disingenuous to suggest and dangerous on the part of those who advise on elaborate tax-avoidance scheme to assume, that Ramsay 's case did not mark assessee significant change in the approach adopted by this House its judicial role to assessee pre-ordained series of transactions into which they were inserted steps that have no commercial purpose apart from the avoidance of tax liability, which in the absence of those particular steps would have been payable. The difference is in approach."

Commenting on this judgment the Supreme Court of India in the McDowell Co. Ltd., Vs. CTO 154 ITR 148(SC) said:

"It is neither fair nor desirable to except the legislature to intervene and take care of every device and scheme to avoid taxation, it is up to the court to determine the nature of new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices for what they really are and to refuse to give judicial benediction."

In the same judgment, Supreme Court Judges made a clear distinction between tax avoidance and tax planning. This is what the judges of the Supreme Court have said in the same case:

"Tax Planning may be legitimate provided it is within the framework of law. Colorable devises cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honorable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges."

Form the above it is very clear that tax planning by Assessee Company cannot be called a crime or an illegal activity or an immoral action as is wrongly considered by confused thinkers on the subject. What constitutes a crime is tax evasion and what is undesirable is tax avoidance but it is certainly desirable to engage in the exercise of tax planning.

In UK, wherefrom the principal coined in McDowell's case was coined, the House of Lords expressly reaffirmed the basic principle, 'A subject is entitled to arrange his affairs so as to reduce his liability to tax. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides'.

The House of Lords expressly reaffirmed the cardinal principle of *Duke of Westminister,* 'Given that a document or transaction is genuine, the Court cannot go behind it to some supposed underlying substance'. They only ruled against the principle being overstated or overextended.

Mukharji J, who in his prompt and lethal report in CWT v Arvind Narottam said: '…no amount of moral sermons would change people's attitude towards tax avoidance', and soon thereafter in UoI v Playworld Electronics stated: 'one should avoid subverting the rule of law'. As a matter of law, the Supreme Court in these two latter cases reiterated that where the true effect

of a transaction is clear, the appeal to discourage tax avoidance is not a relevant consideration.

In any event, when the language of a deed of settlement is clear, an attempt to invoke McDowell would be futile even if the deed results in tax avoidance. as the Madras High Court held in Valliapan Vs. ITO, McDowell does not hit tax planning.

The manner in which McDowell is to be dealt with was well summed up by the Gujarat High Court in Banyan and Berry Vs. CIT thus:

The court (in McDowell) nowhere said that every action or inaction on the part of the taxpayer which results in reduction of the tax liability to which he may be subjected in future, is to be viewed with suspicion and be treated as a device for avoidance of tax irrespective of legitimacy or genuineness of the act…. The principle enunciated in the above case has not affected the freedom of the citizen to the act in a manner according to his requirements, his wishes in the manner to do any trade, activity or planning his affairs with circumspection, within the framework of law, unless the same falls in the category of colourable device.

The House concluded that steps which had no commercial purpose and had been artificially inserted for tax purposes into a composite transaction, should be disregarded; but that a transaction which came into statutory language could not be disregarded merely because it was entered into solely for tax purposes.

Therefore, while tax planning these principles emanating from court made law need to be kept in sight. Otherwise, planning looking good on paper may fail in practice.

Tax Management

Planning which leads to filing of various returns on time, compliance of the applicable provisions of law and avoiding of levy of interest and penalties can be termed as efficient tax management. In short, it is an exercise by which defaults are avoided and legal compliance is secured. Through proper tax planning and management, the penalty of upto Rs.100000 for delay in furnishing of tax audit reports u/s 44AB can be avoided.

Similarly by applying for Permanent Account Number (PAN), the penalty under the Act can be avoided. The borrowal of loan otherwise than by way of an account payee cheque or bank draft attracts 100% penalty and this can be avoided by conscious planning of the execution of loan transactions. Planning is a perception conceived on legitimate grounds and achieved through genuine transactions within the framework of law e.g. contribution to Public Provident Fund and claiming rebate u/s 88 of the Act. The filing of the returns with all proper documentary evidence for the various claims, rebates, reliefs, deductions, income computations and tax liability calculations would also be termed as tax management.

Tax management is also an important aspect of tax planning.

Assessee is exposed to certain unpleasant consequences if obligations cast under the tax laws are not duly discharged. Such consequences take shape of levy of interest, penalty, prosecution, forfeiture of certain rights, etc.

Therefore, any effort in tax planning is incomplete unless proper discharge of responsibilities is not made.

Tax management includes:

1. Compiling and preserving data and supporting documents evidencing transactions, claims, etc.
2. Making timely payment of taxes e.g. advance tax, self assessment tax, etc.
3. TDS and TCS compliance
4. Following procedural requirements e.g. payment of expenses or acceptance of loans or repayment thereof, over Rs. 20,000 by account payee bank cheque or bank draft, etc.
5. Compliance with the prescribed requirements like tax audit, certification of international transactions, etc.
6. Timely filing of returns, statements, etc.
7. Responding to notices received from the authorities.
8. Preserving record for the prescribed number of years.
9. Mentioning PAN, TAN, etc. at appropriate places.
10. Responding to requests for balance confirmation from the other assessees.

Tax Implications in Planning

The main objectives in any exercise on tax planning are to :—

1. Avail all concessions and relief's and rebates permissible under the Act.
2. Arrange the affairs in a commercial way to minimize the incidence of tax.
3. Claim maximum relief where taxes are paid in more than one country.
4. Become tax compliant and avoid penalties, prosecutions and interest payments.
5. Fruitful investment of savings.
6. Timely compliance of procedural requirements like tax audit, TDS, TCS, etc.
7. Appropriate record keeping
8. Avoidance of litigation.
9. Growth of economy and its stability.
10. Pay taxes – not a penny more, not a penny less.

Legal Status of Business Units

Individuals, HUFs, AOPs, BOIs:

The incidence of tax would vary depending upon the legal constitution of the person. In the case of individuals, HUFs, AOPs or BOIs and every artificial judicial person (except where different rates or maximum marginal rates are specifically provided), the tax rates are as under

Up to Rs.110000	Nil
Rs. 110001 to 150000	10 percent
Rs. 150001 to 250000	20 percent
Above 250000	30 percent

In case of every individual, being a women, resident in India and below the age of 65 years at any time during the previous year, the rate of income-tax on total income will be as under –

Up to Rs.145000	Nil
Rs. 145001 to 150000	10 percent
Rs. 150001 to 250000	20 percent
Above 250000	30 percent

In case of every individual, being a resident in India, who is of the age of 65 years or more at any time during the previous year, the rate of income-tax on total income will be as under –

Up to Rs.195000	Nil
Rs. 195001 to 250000	20 percent
Above 250000	30 percent

In addition to the above surcharge at 10% is leviable in case the total income exceeds Rs.1000000. Surcharge is calculated on the income-tax payable after claiming rebate u / s 88, 88B and 88C. The same is applicable in respect of tax on long term capital gains u / s 112, tax on undisclosed income assessed under block assessment at 60% u / s 113 and tax rate of 30% in respect of winnings from lotteries, etc u / s 115BB. In case the total income does not exceed Rs.1000000,

The above rates are applicable to AOPs and BOIs where none of the members have taxable income. These rates are applicable to private trusts, political parties and other artificial judicial persons, except where maximum marginal rate is specifically made applicable by law.

Firms and Companies

Partnership firms and domestic companies shall be liable to tax at the rate of 30%. Surcharge @ 10% is payable on the income-tax if income exceeds rupees one cr. Education cess @ 2% and Secondary and higher secondary education cess @1% of income tax plus surcharge is applicable to all firms and companies.

The formation of a partnership firm even in the corporate sector as a method tax planning is very popular as it enables the distribution of profits even amongst minor and ladies of the family of directors who cannot otherwise have large incomes. All profits of a partnership firm after allowing deduction at 12% interest on capital or salary to working partners are normally distributed to the partners. It is often advantageous for individuals to convert their sole proprietary business into a partnership concern and to take the loan creditors as partners and not to further convert the business into a company. That is why even the corporate sector one of the accepted and well – known methods of tax planning is by the formation of a partnership firm and by getting it assessed as a firm by the Assessing Officer. Ladies can also join a partnership firm as full-fledged partners and can be assessed separately in respect of their salary or interest income from the firm.

Sometimes it is advantageous for a sole proprietary concern to convert the same into a limited liability company. In case of a sole proprietary concern, surcharge becomes applicable when income exceeds Rs. 10 lac. A limited liability company enables the director's remuneration and salaries to the members of the family to be regulated within the purview of law so as to achieve the best advantage of income -tax rates. The total corporation tax on industrial profits and the personal income – tax on the salary and perks are sometimes lower than the individual income – tax on income falling in the highest income bracket. This is an immense benefit and is usually taken advantage of in the formation of a company and results in preservation of working capital. Generally speaking, where the individual income is substantially high and the profits are derived from industries it is advantageous for individuals to convert the business into private Ltd. companies. When the remuneration payable to the directors is taken into consideration, the incidence of income – tax on the conversion of the sole proprietary concern into a limited company is very much lessened.

One of the most important questions that is often asked in the case of medium scale business enterprises is: whether it would be advisable for a partnership firm to convert itself into a limited company? There is no straight answer to this question as the answer to the question

would depends upon the facts and circumstances of each case. In the case of partnership firm income – tax payable by firm @ 30% plus surcharge as applicable, partners pay tax on salary and interest. It contrasts with this position the income – tax payable by company is 30% and applicable surcharge but various perquisites, many of which are tax-free for employees. Thus, generally speaking, the effective rate of income-tax payable by a closely held company and directors is much lower than the highest income-tax rates payable by the firm and the partners. Besides, there are various allowances which, if given to the partners of the firm on becoming directors or executives of the company, get complete tax deduction while computing the taxable income of the company like salary and perquisites. The salary and perquisites payable to the partner are not fully allowed as a deduction while computing the income of the partnership firm whereas the same are allowable as a deduction while computing the income of the company concerned. There are various perquisites like rent – free residential accommodation, medical reimbursement, etc., which are completely exempt from income-tax up to a certain level of the perquisite value and only a very nominal amount is added as the taxable value of the perquisite whereby a lower amount becomes taxable in the hands of the employees concerned.. Besides, in the case of a company it is possible to distribute the share capital to the various members of the family in such a way that the dividend distributed by the company gets a complete exemption under section 10(33).

All these factors combined together generally result in a lower rate of income-tax incidence in the case of a company and for the directors and executives as compared to the partnership firm and it members. However, the answer to question whether a partnership firm converts itself into a limited company depends upon the total income of the firm, the various individual incomes of the individual members who were partners and who now become directors or executives of the companies and various other circumstances, the correct answer can be found only on completing this calculation. In the case of two alternatives, when the second alternative, i.e. of formation of a company through the conversion of the partnership firm into the company, results in a lower incidence of tax from the company and the directors together, in comparison to that in the case of the partnership firm and the partners together, then it is a case for consideration as to whether through proper tax planning the firm should convert into a limited company. In most of the cases, it may not be possible to convert the partnership firm into a limited company even though the rate of income-tax generally applicable to the profits and gains of the public limited company is 30% plus applicable surcharge thereon. Yet due to various formalities and the complications involved in the process of running a public limited company, it may not be worthwhile for a firm to convert themselves into a public limited company straightaway.

Under the provisions of section 45(4) of the income-tax Act income-tax is payable on the deemed capital gains if there is a distribution of capital assets on the dissolution or otherwise of a partnership firm. Where a partnership firm is converted into a private limited company or a public limited company, and the assets are taken over at the written down value in the income-tax records, there is no capital gain accruing to partnership firm as such. As there is no distribution of capital assets on the dissolution of a firm which is simply a necessary step made to effect conversion of the firm into a limited company, there is also no deemed capital gains under

Section 45(4). Hence, there is no risk of income-tax payable on the deemed capital gains when there is a conversion of a partnership firm into a company.

When a partnership firm converts into a limited company, whether a private or a public one, it loses the advantages of carry forward of unabsorbed depreciation and a carry forward of past business losses.

Under the new Section 47(xiii) of the Act full exemption would be allowed in case of capital gains on the conversion of a partnership firm into a company effective from AY 1999-2000. Thus, it is provided that where a firm is succeeded by a company in the business carried on by it as a result of which the firm sells or otherwise transfers any capital assets or intangible assets to the company, the entire capital gains would be exempt from tax provided that the following conditions are fulfilled:-

(a) All the assets and liabilities the firm relating to the business immediately before the succession becomes the assets and liabilities of the company;

(b) All the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of succession;

(c) The partners of the firm do not receive any consideration or benefit directly or indirectly, in any form or manner other than by way of allotment of shares in the company; and

(d) The aggregate of the shareholding in the company of partners of the firm is not less than 50% of the total voting power in the company and their shareholding continues to be as such for a period of five years from the date of succession.

Likewise, when a sole proprietary concern is succeeded by a company in business carried on by it as a result of which the sole proprietary concern sells or otherwise transfer any capital asset or intangible assets to the company, the entire amount of capital gains would be fully exempt from tax under Section 47(xiv) from the AY 1999-2000. However, the following conditions will have to be fulfilled;

(a) All the assets and liabilities of the sole proprietary concern relating to the business immediately before the succession become the assets and liabilities of the company;

(b) The shareholding of the sole proprietor in the company is not less than 50% of the total voting power in the company and his shareholdings continues to so remain as such for a period of five years from the date of the succession; and

(c) The sole proprietor does not receive any consideration or benefit, directly or indirectly, in any form or manner other than by way of allotment of shares in the company.

Section 47A(3) has, with effect from AY 1999-2000 as inserted by the Finance (No. 2) Act, 1998 provided that if any of the above conditions are not complied with, the benefit availed by the firm or the sole proprietor, as the case may be, would be deemed to be profits and gains charge-

able to tax of the successor company for the previous year in which the above requirement are not complied with.

Foreign Companies:

The effective tax rate applicable to a foreign company is 40%. In respect of certain specified income, such as royalty, fees for technical services, etc, special rates of tax are prescribed at 20% or even less. The ultimate tax liability of a foreign company or any other non- resident will depend upon the applicability of Double Taxation Avoidance Agreement (DTAA), if any entered into between India and the respective country. The rates prescribed under the DTAA or the normal rates prescribed under the Act, whichever is more beneficial to the assessee shall be applicable.

Cooperative Societies:

The rate of tax applicable to cooperative societies is as under:

Income	Rate of tax
Upto Rs. 10000	10%
Rs10001 to Rs. 20000	20%
Above Rs. 20000	30%

Local Authority:

In the case of local authorities, the rate of income-tax specified is 30% on the whole of the total income.

Tax Planning and Salaries

A good remuneration package is one, which meets the following objectives:

1) Optimizing the tax liability of the employee.

2) Maximizing the take-home pay.

3) No disallowances are faced by the employer in respect of such remuneration.

4) Incidence of Fringe Benefits Tax (FBT) on employer.

Taking the above objectives, the following are some the tax planning measures:

1) Instead of paying fixed amount of salary, the salary can be structured into basic pay with allowances and perquisites so that the employee can avail exemptions under various provisions. Employer in any case can claim deduction for the all amounts paid e.g. conveyance allowance paid to meet the expenditure in performance of duties of an office which is exempt under section10(14) in the hands of employees.

2) In respect of the own accommodation provided to the employee, employer is eligible to claim depreciation on such accommodation. The employer also can avail the repairs and

maintenance and other cost as business expenses. The employee will be taxed for the perquisite of rent free accommodation, which is concessionally valued. Moreover, the employer will have advantage of appreciation in value of the property.

3) The employer can institute welfare oriented long term savings on behalf of the employee such as recognized provident fund (RPF), approved superannuation fund, pension plans, gratuity fund which are exempt from tax in the case of employee and deductible in the case of employer, incidentally such measures compel the employee save in rainy days.

4) To ensure that dearness allowance forms part of salary because incidence on entertainment allowance, gratuity, commuted pension and employer's contribution to RPF is considerably reduced. Any commission scheme paid as a percentage of turnover can also be introduced as it serves the above objective.

5) The employer may introduce LTC facility at all levels as this is exempt u / s 10(5) subject to limits provided therein and the employee shares the benefit with his spouse, children and dependent parents, brothers and sisters.

6) The employer may introduce leave encashment facility, as employee can earn tax free remuneration under section 10 (10AA).

7) Certain perquisites are not taxable in the hands of employees while employer is also not liable for FBT :

   i) food or beverages provided by the employer to his employees in office or factory

   ii) provision of paid vouchers which are not transferable and usable only at eating joints or outlets

   iii) conference fee for participation

   iv) facilities to fulfill any statutory obligation or mitigate occupational hazards

   v) provide first aid facilities in the hospital or dispensary run by the employer

Providing such perquisites is a win-win situation both for an employer as well as an employee.

8) Certain perquisites are not taxable in the hands of employees however the employer is liable for FBT :

   i) Reimbursement of medical expenses up to Rs. 15,000

   ii) Provision of car for personal use,

   iii) Provision of telephone for personal use,

   iv) maintenance of any accommodation in the nature of guest house

   v) festival celebrations

   vi) use of health club and similar facilities;

vii) use of any other club facilities;

viii) gifts;

ix) scholarships;

While providing such perquisites cost of FBT and tax saving of employee can be compared.

Tax Planning and Income from House Properties

The scope for tax planning in respect of property income is very limited since the deductions are specifically stipulated u/s 24 without any flexibility. However the following are illustrative examples as to how tax planning can be achieved under this head:

1. Where a building belonging to HUF is a subject matter of partition, the portion generating income can be allotted to a member who does not derive any income. And in case of the self occupied portion, it should be allotted to the member who has huge income from other sources.

2. Where the construction of a house is being undertaken on the land owned by a husband or wife the amenities such as electrical fittings, sanitary ware etc. can be provided by the other spouse. In such a case the rent can be earned by the owner while the charge for the amenities can be taken by the provider of the amenities. In this way the rent income gets split among the husband and wife. The investment in amenities of course should be made by the spouse who is earning income.

3. Where the tax payer occupies more than two houses for self occupation, he may transfer the house to his major son or daughter or any other family member except the spouse and minor children , who presently reside in that house. In such case, the provisions of section 27 deeming the owner as tax payer will not get attracted. The transferee who becomes the legal owner can treat it as self-occupied and adopt the annual value as NIL. Clubbing provisions of section 24 and section 4 wealth tax would not be applicable.

4. If a second house is proposed to be bought in the name of the spouse then instead of first buying it and the gifting it to the spouse, cash gifts should be thought of and the house should be directly bought in the name of the spouse. It ensures that the expenses on registration and stamp duty are incurred only once. This will avoid applicability of Section 27. However clubbing provisions of Section 64 will be attracted. If such house is self occupied the annual value will be taken as NIL and no tax impact arises even on account of section 64.

5. Interest on loan taken for construction or purchase of house is paid to a non resident outside India; tax should be deducted at source to avoid denial of deduction u/s 25 in computing the taxable income from house property.

6. If assessee proposes to construct/buy two houses out of self-owned as well as borrowed funds, self-owned funds should be invested in the unit which will be self–occupied, while in respect of the unit which is to be let out, borrowed funds can be invested, as there is no restriction in terms of interest deduction u/s 24 in the computation of property income.

7. It is possible that both husband and wife earn income and they may want to invest their funds in a house for self occupation. In such a case, they can raise funds together and become co-owners of the property. Repayment of loan and interest shall be borne by both of them, thereby enabling them to avail deduction for interest in each case upto the permissible limit as well as rebate under section 88 on repayment of principal amount. If properly planned, deduction on account of interest on loan will be available to the extent of Rs. 1,50,000 u/s 24 for each assessee subject to the fulfillment of other conditions and rebates upto Rs. 20,000u/s 88 in case.

8. One of the important considerations while adopting tax planning for investment in real property is particular needs of the family. For example: the house is owned by the head of the family, a portion of the house can be reserved for carrying a business or a profession, etc.

9. Depending upon the liquidity needs of the family, the tenure of the investment in property, whether for a short term of 2 to 5 years or for long term of 5 to 10 years or 15 years or even longer has to be planned.

10. In case of self occupied property obtained from borrowed funds if the interest is subsequently more than Rs. 1,50,000 then possibility of letting it out to other member may be considered because in case of let out property there is not restriction on deduction for interest.

11. Where property is used for business it becomes the part of block of assets. When the block of asset is sold resultant gain is short term capital gain, irrespective of period of holding. When house property is sold which is hold for more than 36 months resultant gain is long term capital gain. Therefore in when own asset is used for business planning can be made availing the benefits of long term capital gains depending upon probable tenure of use.

12. The amount of municipal tax is deductible on 'payment' basis and not on 'due' or 'accrual' basis. It should, therefore, be ensured that municipal tax is actually paid during the previous year if assessee wants to claim deduction. If tax of more that one year is paid in any previous year, the entire amount of tax paid qualifies for deduction in the year of payment.

13. Where the assessee gives certain quarters on rent to his employees and charges rent from them then the rental income would be treated as business income and not income from house property. CIT Vs Delhi Cloth & General Mills Co. Ltd. 59 ITR 162 (Punj). Therefore, there will be no income from house property.

14. Where buildings owned by a company were occupied as rent free by directors and senior executives, it was held building was occupied for business purposes. CIT Vs Vazir Sultan Tobacco Ltd. 173 ITR 290 (AP). Therefore, there will be no income from house property.

15. The assessee can claim certain deduction under Section 57 from the income chargeable under the head " Income from other sources"

    (a) In case of family pension Rs.15000 or 1/3 of such income whichever is lower

(b) In case of machinery, plant or furniture let on hire, cost of repairs, insurance premium, depreciation etc.

Tax Planning and Income from Business or Profession

1. Choosing legal entity:

In view of the differential tax rates prescribed and various concessions and deductions that may be available only in respect of certain entities, choosing appropriate legal form assumes importance. Under the tax laws**,** the definition of the term 'person' is illustrative. Apart from tax considerations would throw up needs to associate with others, ensuring limited liability, capital raising capabilities, etc. Even amongst companies, a company can be a public limited company in which public are substantially interested, commonly known as 'widely held company', a closely held company, etc. There are certain provisions of Income-tax Act that are applicable only to closely held companies. Example: Section 2(22)(e) - deemed dividend, section 79.

Further, with the advent of Dividend Distribution Tax (: DDT - section 115O), take home by owners by way of dividend in case of company DDT is attracted, which is saved in case of a partnership firm. Further tax on book profits (commonly called MAT) is applicable to companies only and not to the other forms of organisations.

2. Nature of business:

Apart from economic factors such as scope, profitability, feasibility factors the benefits and concession available to each line of business may also be pursued before expanding an existing line of business. To illustrate, export business is eligible for tax holiday u/s 10B for 10 years subject to fulfilment of certain conditions. If such a unit is situated in Free Trade Zone (FTZ)/ Special Economic Zone (SEZ), etc. can be explored. Further in the case of certain manufacturing units, hotels, hospitals, and ships covered u/s 80-IB, deduction from profits is available for a period of 10 years / 8 years at the appropriate percentages specified. Infrastructure projects in electricity, communication, natural gas, etc. deductions are provided under section 80IA.

3. Other activities:

Allied activities to existing business can also be planned keeping in view the additional benefits that may be available. Any scientific research activity that may be necessary for promoting or expanding the existing capital and revenue expenditure incurred in connection therewith in computing the profit u/s 35 of the Act.

4. Location of business:

Although certain factors such as nearness to the source of raw materials or market or availability of infrastructure may be factored in taking a decision on the location of the business, tax considerations also play a role. If an industry is located in Backward State or a Backward District, deduction u/s 80-IC is available. Hotels and convension centers in specified ares are al-

lowed deduction under section 80ID. If it is situated in a FTZ or Export Processing Zone (EPZ) or SEZ, exemption u/s 10A is available. Besides, eligibility for subsidy in certain locations would also prove to be attractive.

5. Sources of funds:

An entity mobilizes funds by way of capital stock or debt instruments. Plough back of profits is yet another way of resource mobilisation. In the case of proprietary concerns, the entire profits computed under the law would be taxable without any allowance for salary or interest on the effort and the capital contributed by the owner. In case of partnership firms, the salary and the interest paid to the partners can be claimed as deduction subject to the limits and conditions prescribed u/s 40(b) and the balance profits as computed in accordance with the law shall be taxed at 30% plus applicable surcharge and cess. Interest and salary received by the partners shall be charged to tax as business income to the extent allowed in the case of the firm. In case of the corporate entity, dividend can also be declared on equity to the shareholders in the presence of profits subject to the provision of the Company Law. Declaration of dividend attracts tax @ 15% plus applicable surcharge and cess and in turn the shareholder enjoys tax free income. While dividend is only an appropriation of profits, interest is a charge against the profits. On payment of dividend, the taxable income of the company remains unaltered. However, interest on loans or debentures is deductible from profits of the business. The financial commitments on loan obligation may lead to or enhance the business loss irrespective of whether the business earns profit or not. It would always be better to have proper debt-equity ratio and clear policy on return on capital employed.

6. Ownership Vs lease of assets:

This is more elaborately discussed elsewhere in study material and this is yet another factor that is considered as an area of tax planning.

7. Commencement of business:

In availing certain exemptions or deductions that are permissible for certain number of years under the provisions of the Income-tax Act, the timing of the commencement of business assumes significance. For example Section 10A, 10B, 32, 35A, 35D, 80-IA, etc.

Besides expenditure incurred prior to commencement of business can be either capitalised or amortised u/s 35D. However deduction cannot be claimed in respect of such expenditure after commencement of such business unless expressly stated as in the case of section 35 with reference to scientific research expenditure during three years preceding commencement of business.

Interest on loan borrowed required to be capitalised upto the date of commencement of production as was held in Challapalli Sugars Limited Vs CIT 98 ITR 167 (SC). This decision is supplemented by an explanation 8 to section 43(1) which makes it clear that interest relating to the period after the asset is first put to use shall never form part of actual cost.

Interest relating to the period after the business commences but before the asset is first put to use can still be claimed as revenue expenditure-34 ITR 265 (Bom); 120 ITR 37 (Kar). Interest on loans borrowed and used for acquisition of asset for business expansion and diversification is a revenue expenditure – CIT Vs Prithvi Insurance Company Limited 63 ITR 632 (SC); Produce Exchange Corporation Limited Vs CIT 77 ITR 739 (SC); BR Limited Vs CIT 113 ITR 647 (SC); 169 ITR 499 (Raj). However, section 36 the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession; for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction. Therefore, such interest should be capitalised and depreciation should be claimed on enhanced value of asset.

8. Choice of method of accounting:

Section 145 of the Act stipulates that the income of profits and gains of business or profession and income from other sources shall be computed on the basis of method of accounting regularly employed by the taxpayer. Though an assessee has the option of either accrual or cash or hybrid system of accounting, the corporate bodies are required to follow accrual system of accounting only u/s 209 of the Act. Further section 145 as amended with effect from assessment year 1997-98, does not recognize hybrid system of accounting. The revenue recognition irrespective of the method followed has to have nexus with the nature and character of the amount accrued or received and the year of such accrual or receipt - State Bank of Travancore Vs CIT 158 ITR 102 (SC); City Bank's case 208 ITR 930 (Bom). Also CBDT circular 491 dated 30-06-1987 (166 ITR St. 149); 49 ITD 190; 50 ITD 14. A mere book entry or an accounting treatment may not be relevant or conclusive evidence for tax purposes. Not recording of expenditure in the books will not render such expenditure inadmissible for tax purposes - Kedarnath Jute Mfg. Co. Ltd Vs CIT 82 ITR 363 (SC). By routing an item of income through suspense account to the balance sheet instead of the P&L account by crediting the relevant income head will not deny the chargeability of such item- State Bank of Travancore Vs CIT 158 ITR 102 (SC). It is open to an assessee to change the method of accounting regularly adopted by him, provided it is not for a casual period. Such a bonafide change should be accepted even if it results in reduction of tax liability- 193 ITR 349 (Bom); 42 ITD 35; 43 TTJ 319. However an assessee cannot be permitted to maintain mercantile basis for other laws and cash basis for income-tax purposes - 43 ITD 386. Every assessee covered by the provisions of section 44AA read with Rule 6F is required to maintain proper books of account. Once the books are so maintained, computation of taxable income shall be on that basis. Where the books of accounts are incomplete or incorrect, the Assessing Officer can reject the books of accounts and complete the assessment u/s 144. The same consequence would follow if the assessee does not follow the accounting standards notified u/s 145(2) with effect from AY 1997-98.

9. Stock valuation:

Inventories should normally be valued at lower of the historical cost and net realizable value. Either FIFO or weighted average method or specific identification method in certain circumstances as permitted in AS-2 issued the Institute of Chartered Accountants of India can be followed. As per the revised standard, the other methods namely LIFO, average cost, base

stock method have been omitted. Similarly in the case of manufactured inventories, only absorption costing method is recognized. Section 1 45A of the Income-tax Act requires valuation of purchase and sale of goods and inventory in accordance with the method of accounting regularly employed by the assessee. To such valuation, adjustments towards duty, tax, cess or fee actually paid or incurred to bring the goods to the place of its location and condition as on the date of valuation is allowed. Such inclusion should be without giving credit for any benefit that may accrue in the form of Modvat, etc. Therefore for tax purposes, the principle involved is inclusive of duties, etc. Dual method of accounting, one for tax purposes and another for bookkeeping is well recognised – United Commercial Bank Vs CIT 240 ITR 355 (SC). The Assessing Officer has power to substitute incorrect method with proper method as was held in British Paints India Ltd. 188 ITR 44 (SC). When the method of valuation is changed, the valuation of opening stock need not be disturbed and the difference between the old and new methods of valuation of closing stock should not be included for assessment – Carborandum Universal Ltd. 149 ITR 759 (Mds); Mopeds India Ltd. 173 ITR 347 (AP). Where the firm is dissolved, the closing stock should be valued at market rates – ALA firm Vs CIT 189 ITR 285 (SC). If the stock of the firm is taken over by a partner at cost, the value of the stock should be based on market rates to arrive at the correct profit taxable in the hands of the firm. If there is no discontinuance of the business on account of dissolution and the remaining partners reconstitute the firm, the stock need not be valued at market price. It can be valued at cost or market price; whichever is less – Sakthi Trading Co. Vs CIT 250 ITR 871 (SC). Where the firm is converted into a company as a going concern with identify of beneficial ownership remaining the same, there is no need for stock valuation – CIT Vs Koder 233 ITR 620 (Ker).

10. Expenditure on scientific research:

(a) Expenditure incurred on in-house R&D is a business expense, if the research is related to the business. In certain cases possibility of weighted deduction exists, where necessary approvals are obtained.

(b) If the research is not related to the business, it would be better to contribute to an approved research association to undertake such research work. Such contribution is business expenditure.

(c) Land acquired for R&D project is not business expenditure. If the same land is taken on lease, lease rentals paid is business expense u/s 35 as well as under section 37. d) Where any asset used for scientific research is sold without having used for any other purpose, the implication of deemed business profits u/s 41 should be analysed.

11. Travel expenses:

The travel expenses of the spouse were held inadmissible, if such travel is not for business consideration - CIT Vs T. S. Hajeemoosa & Co., 153 ITR 422 (Mds). If the wife were to travel on account of business expediency, she may be made a partner in the firm. In such case both the husband and wife can travel not only as business partners but also as life partners and claim

business expenditure on travel. The share of profit of the spouse cannot be clubbed with that of the husband as the same is exempt u/s 10(2A).

12. Employee welfare funds:

The contribution of the employees' welfare funds should not be delayed beyond the time limits prescribed tinder the relevant Acts. It would be better to borrow and pay the tax liability on or before the relevant due date. Contribution made to the welfare funds after the due date does not qualify for deduction even in the year of payment. However interest on money borrowed for meeting this liability qualifies as business expense.

13. Diasllowances

There are certain provisions which provide for express disallowances. In certain cases disallowance is attracted only if the conditions laid down are not observed. Care should be taken to avoid disallowance by making necessary compliances. For example:

i) Interest, salary, royalty, fees for beneficial services or any other sum payable outside India is not deductible unless tax is deducted at source or tax is paid.

ii) TDS where required is not made or not paid to the government in case of payments to residents.

iii) In case of partnership, Interest to a partner or remuneration to any working partner by a firm is not deductible unless the necessary conditions are fulfilled.

iv) Any payment by way of interest, salary, bonus, commission or remuneration paid by an association of persons or body of individuals to any of its members is disallowed.

v) Where the assessee incurs any expenditure incurred over Rs. 20,000 otherwise than by account payee cheque drawn on a bank or account payee bank draft, deduction will not be allowed in respect of such expenditure.

14. Fringe Benefits Tax (FBT)

Certain expenses are exposed to FBT. This tax incidence should be reduced. Discussion is made elsewhere.

15. Allocation of Expenses between Exempt and Taxable Sources of Income:

Expenditure incurred in relation to income not includible in total income is not deductible from income under any source which is taxable (Section 14A).

It is, therefore necessary to plan as follows:

1. Investments for sources that yield tax free income e.g. agricultural income, shares (since dividend is exempt), P.P.F. deposit (since interest is exempt), SEZ, etc. should be made from own capital. If borrowed funds are necessary less costly funds should be used for such activities.

2. Where common overheads are incurred, while availing benefit foe exempt source keeping in view that part of such common costs will be apportioned. Therefore, care should be taken to preserve data that will help in reducing such allocation to exempt source e.g. instead of using any vehicle from the common fleet, depending on user, less expensive vehicle can be directly allocated and used for exempt source.

This provision is applicable to all sources of income

Tax Planning and Income from Capital Gains

1. Capital gains is chargeable to tax in the year in which the transfer takes place except in certain exceptional cases such as compulsory acquisition by Government, conversion of capital asset into stock in trade, insurance claim received on destruction of the asset.

It is therefore not advisable to transfer the properties without ensuring availability of cash for tax payment and investment for saving capital gains tax.

2. Where joint property development is resorted to by landowner with the builder and if the consideration is receivable in built up area to be constructed, it is advisable to avoid the applicability of section 53A of the Transfer of Property Act. This can be achieved by granting licence to the builder to enter the premises and develop the property without giving any rights of enjoyment of the property. The possession still remains with the landowner and the same will be handed over as and when the built up area is constructed and delivered. In this way, the transfer will take place only in the year in which the built up area is sold and not before. However, the gain from land will be capital gain and that from development activity will be business income.

3. The capital gains tax will arise only where the investment is a capital asset within the meaning of section 2(14). If the investments are not capital assets, the capital gains tax will not arise. E.g. personal effects of movable nature such as silver, household utensils, motorcar, agricultural lands outside the specified area, etc.

4. Planning can be done in such a way that the capital asset is transferred through any transaction, which is not regarded as transfer under section 47 i.e. transfer in a scheme of amalgamation, transfers between 100% subsidiary and holding companies, partition of HUF, etc.

5. Where an asset is transferred, it can be ensured that it is a long-term capital asset so that the benefit of indexation can be availed and the concessional rate of tax prescribed u / s 112 can be availed.

6. Exemptions u / s *54*, 54B, 54D, 54EC, 54ED, 54F, *54G* can be availed.

7. It must be noted that chapter VI A deductions and rebate cannot be claimed in respect of long-term capital gains - section 112).

8. In respect of capital gain arising on account of:

   (a) Conversion of capital asset into stock in trade;

(b) Compulsory acquisition under any law in force; taxability does not arise in the year of transfer.

In the case of conversion, it arises only in the year of sale of stock in trade and in the case of compulsory acquisition; it arises in the year of receipt of compensation. Wherever permissible, year of chargeability can be accordingly planned. Where adhoc amount is received pending dispute in the case of compulsory acquisition, the same cannot be charged to tax - CIT Vs Hindustan Housing & Land Development Trust, 161 ITR 524 (SC).

9. In the case of non-residents, foreign companies, foreign institutional investors and overseas corporate bodies, the special and the concessional rates prescribed under sections 112, 115A can be taken advantage of.

10. Where an asset is acquired prior to 01-04-1981 is transferred, the fair market value as on that date can be availed as the cost of acquisition as it may be more than the actual cost.

11. Subject to fulfillment of conditions, planning can be done to claim exemptions u/s 54 to 54G. If the investment in the eligible asset is not immediately possible, then deposit under capital gains account scheme can be made within the due date for filing the return or before the actual date of filing the return of income, whichever is earlier.

12. Even if the amount deposited in capital gains account scheme is not utilized within the stipulated period, the amount shall be taxed as capital gain only in the year in which such period expires and not in the year in which exemption was availed. Therefore it postpones the liability to capital gains tax.

13. Where exemptions under sections 54, 54B, 54D or 54G had been claimed in respect of any asset acquired, transfer of such asset within three years will result in the reduction of the amount of such exemption from the cost of acquisition of such asset. This will have the effect of increasing the short term capital gain and assessee will end up paying more tax, whereas exemption earlier availed might be in respect of long term capital gain which was taxable at a concessional rate u/s 112. Therefore the new asset should not be sold within a period of 36 months. In the alternative, loan can be availed by mortgaging the property to meet any financial crisis and such loan can be cleared by selling the property after 36 months.

14. Where the assessee transfers an agricultural land situated in a specified area, he can avail exemption u/s 54B by investing in another agricultural land. If the agricultural land so acquired is outside the specified area, the exemption can still be availed. If such agricultural land is sold even within 36 months, there will not be any tax implication as it is not a capital asset.

15. Where an assessee holds original shares as well as bonus shares in a company and intends to transfer part of his holdings, bonus shares can be retained and original shares can be transferred. This will enable the assessee to reduce the capital gain by availing deduction for the cost of acquisition. Imagine if bonus shares were to be sold, the cost of acquisition would be NIL and more the tax liability!

16. Where any long-term capital asset is transferred and is invested in the eligible asset, exemptions are available in the computation of capital gain. The Kerala High Court has held that where the net consideration on sale of asset is invested in business and later on money is borrowed for investment in the eligible asset within the time limit prescribed, the exemption is allowable - ITO Vs K C Gopal, 107 Taxmann 591 (Ker). Following this analogy an assessee may invest the net consideration in business or use it for any other purposes. Housing loan can be obtained for investment in house property to avail exemption u/s 54 or 54F as the case may be. Assessee can avail interest as deduction u/s 24, repayment of principal u/s 88 as rebate. The loss if any computed under the head income from house property can be set off against business income.

17. As far as possible taxpayers should so plan as to transfer their capital assets normally only 36 months* after acquisition since long term capital gain lower capital gain. It is important to note that if capital asset is one which became the property of the assessee in any of the manner as specified u/s 49(1), the period for which it was held by the previous owner is also to be counted in 36 months*.

The reason for this is the category of gain becomes a 'long term capital gain' and in such a case tax rate is lower as well as certain opportunities for tax saving are also prescribed for it.

[*12 months in case of Equity or Preference shares in a company, Securities, Units of UTI, Units of a mutual fund specified under section 10(23D)]

18. Provision of section 47A apply and exemption availed u/s 47 is withdrawn under certain circumstances e.g. ceasing of 100% subsidiary status, failing to maintain condition for conversion of proprietary/partnership in to company, etc.

Withdrawal of exemption should be avoided.

19. In case of sale of an undertaking instead of selling assets in piecemeal possibility of slump sale u/s 50B should be explored. In such a case if the undertaking is more than 36 months the entire gain will be considered to be of long term nature.

20. In respect of asset on which depreciation has been claimed, capital gain is of short term nature. However, for the purpose making investment and claiming exemption if the asset is held for more than 36 months it can be considered as a long term capital asset – ACE Builders Ltd. Vs ACIT 76 ITD 389 (Mum).

21. Exemption from tax is provided under section 10 (*38*) for any income arising from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund where—

    (*a*) the transaction of sale of such equity share or unit is entered into on or after the date on which Chapter VII of the Finance (No. 2) Act, 2004 comes into force; and

    (*b*) such transaction is chargeable to securities transaction tax under that Chapter :

22. Concessional Tax rate of 10% (from A.Y. 2009-10 – 15%) on short term capital gains is applicable under section 111A for short term Capital gains arise from the transfer of an equity share in a company or a unit of an equity oriented fund if securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004 is paid.

Tax Planning and Income from Other Sources

1. Assessee share holder having substantial interest in assessee closely held company and not having any credit balance with the company makes withdrawals during the accounting year. Such withdrawals would amount to receipt of notional divided. Subsequent adjustment against the credit balance of another shareholder on the last day of the accounting year will not alter the position. the shareholder is chargeable to tax on the deemed dividend by virtue of section 2(22)(e) – Miss. p Sarada Vs CIT, 229 ITR 444 (SC).

2. Where composite rent is received from tenant in respect of property it should be split up and the amount attributable to the amenities should be assessed as income from other sources and amount attributable to the building should be computed u/s 22.

3. Where an assessee borrows for the purpose of investment in shares and securities, interest on the loan is an allowable expenditure even there is no income – CIT Vs Rajendra Prasad Moody, 115 ITR 519 (SC).

4. Winnings from motorcar rally is assessee return for skill and endurance and is taxable as income and can not be treated as casual and nonrecurring receipt – CIT Vs G R Karthikeyan, 201 ITR 866 (SC)

5. In the case of winding up of company, where interest is earned by Official Liquidator fixed deposits, expenditure incurred on establishment charges and staff salary are not deductible from such interest income – Swami Motor Transports Pvt. Ltd. Vs CIT, 217 ITR 241 (Mad). On the same basis, where an assessee takes a loan against security of fixed deposit, interest on such interest is not deducted from the interest income earned on the fixed deposit – CIT Vs Dr. V P Gopinathan, 248 ITR 449(SC).

6. Interest income earned on the deposits made out of surplus funds before commencement of business is taxable as Income from other sources. The interest income so derived from out of investment in the nature of deposit cannot be reduced from the cost of construction as it has no nexus with the construction of plant – Tuticorin Alkali Chemical & fertilizers Ltd. Vs CIT, 227 ITR 172(SC); CIT Vs Coromendal Cements Ltd., 234 ITR 412 (SC). If loan is borrowed from IDBI and placed in short term deposits till the money is paid to the supplier of plant and machinery, the interest earned thereon cannot go to reduce the cost of plant and machinery, but will be charged under Income from other sources – CIT Vs Autocast Ltd., 248 ITR 110(SC).

7. If the receipts during the construction period have close nexus with the construction, the amount shall be regarded as capital receipts and would go to reduce the construction cost of the plant. The following receipts are treated as capital:

(a) Rent charged from contractors for housing workers and staff employed by contractor for construction work of the assessee.

(b) Hire charges for plant and machinery given to contractors for use in construction work.

(c) Interest from advances made to contractors for purpose of facilitating construction work.

(d) Royalty for excavation and use of stones lying on assessee's land for construction work and therefore taxable – CIT Vs Bokaro Steels Ltd., 236 ITR 315 (SC).

8. Any amount deposited to open Letter of Credit (LC) for purchase of plant and machinery required for setting up assessee plant, interest on such amount is directly connected and incidental to construction of plant. Therefore interest receipt is capital in nature and would reduce the cost of asset – CIT Vs Karnal Cooperative Sugar Mills Ltd., 243 ITR 2 (SC). The ratio laid down in Tuticorin Alkali's case is not followed by the court but has applied the rationale followed in Bokaro Steel Ltd case. Similar view has been upheld in Karnataka Power Corporation, 247 ITR 268 (SC) and Bongaigaon Refinery & Petrochemicals Ltd., Vs CIT ITR 329(SC).

9. The assessee inherited the assets and liabilities on the father's death. The overdraft was taken by his father from bank by pledging securities to meet tax liabilities. the interest on overdraft claimed as deduction against income from securities received by the assessee. Distinction should be made between assets being charged with obligation to discharge the liability and income from assets being charged with liability to pay interest. In this case, interest is not diverted by overriding title and it is only application of income to pay interest. Assessee not entitled to deduction of interest payments – CIT Vs Mathubhai. C. Patel, 238 ITR 403 (SC)

10. Under section 10 (*34*) any income by way of corporate dividends referred to in section 115-O are exempt from tax and under section 10 (*35*) any income by way of dividends on units of mutual funds are exempt from tax. Therefore, investment in such instruments be preferred to debt instruments or interest bearing deposits, etc.

Gift is Income from other sources

Section 56 provides that certain 'Gifts' received by an assessee shall be chargeable to income-tax under the head "Income from other sources". Definition of 'income' now considers certain gifts received as income.

It is provided that where any sum of money is received, the aggregate value of which exceeds fifty thousand rupees, without consideration, by an individual or a Hindu undivided family, in any previous year from any person or persons on or after the 1st day of April, 2006, the whole of the aggregate value of such sum shall be deemed to be income from other sources.

However, from the purview of the provision that 'gift' being considered as income, certain exemptions are provided. The gifts received which are not considered as income are the following :

(a) received from any relative;

(b) received on the occasion of the marriage of the individual;

(c) received under a will or by way of inheritance;

(d) received in contemplation of death of the payer;

(e) received from any local authority as defined in the Explanation to section 10(20);

(f) received from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in section 10(23C)

(g) received from any trust or institution registered under section 12AA.

For the purposes of this provision, "relative" means

(i) spouse of the individual;

(ii) brother or sister of the individual;

(iii) brother or sister of the spouse of the individual;

(iv) brother or sister of either of the parents of the individual;

(v) any lineal ascendant or descendant of the individual;

(vi) any lineal ascendant or descendant of the spouse of the individual;

(vii) spouse of the person referred to in clauses (ii) to (vi).

Therefore, as a tax planning measure,

1. The 'gift' should be received from the categories listed for exemption, as aforesaid.

2. Since gift received in the form of 'any sum of money' is being treated as income, gift should be received in kind e.g. gold, silver, land, house, furniture, gadgets, etc. as gift in kind will not be treated as income.

Tax Implications on International Joint Ventures

Under the existing provisions of the Income Tax Act in India, a resident is taxed on his global income subject to specific exemptions and deductions sanctioned under the law. Under section 9 of the Income Tax Act, any income that is deemed to accrue or arise in India is taxable. The crucial factor in determining the deeming accrual in India is the existence of 'business connection'. Equally important is the Double Taxation Avoidance Agreement (DTAA) if it exists between India and the respective country.

The concept of 'Permanent Establishment' (PE) dealt with in each DTAA is for taxability of certain income with reference to the country in which the income is earned. Normally the two important criteria for taxability under any tax law are the 'residence' and the 'source'. On account of this, when a resident of the country derives income from a source in other country, he is likely to get taxed both in the residence country (Home state) and the source country (Host state). This gives rise to double taxation of the same income in the case of same person by two different countries. If DTAA exists double taxation is avoided either by exemption or by tax credit method. Under our tax laws a resident gets relief u / s 90 and91 of the Act. The specific provisions of the DTAA should override the general provisions of the Income Tax Act.

As per the source of the Income Tax Rule, the income may be subject to tax in the country where the source of such income exists (where the PE is situate or where the asset or property is located) whether the income earner is a resident in that country or not. On the other hand the income earner may be taxed on residential basis in the country. For example, if a person is a resident of a country, he may have to pay tax on the income earned outside the country as well. Further some countries may follow a mixture of the above two rules. Thus a problem of double taxation arises if the person in respect of any income on the basis of source of income rules in one country on the basis of residence in another country or on the basis of mixture of the above two rules. Relief against such hardships normally takes either of the two routes-

(a) Bilateral relief and

(b) Unilateral relief.

The Governments of two countries can enter into treaty agreements under bilateral relief and where no such treaty agreements exist, the home state can provide relief unilaterally in respect of such double taxation issues (Section 90 and 91).

Under section 90 of the Act, the Central Government may enter into an agreement with the Government of any country outside India to provide for the following:

a) A relief in respect of income on which income-tax has been paid in both the countries

b) The type of income, which shall be chargeable to tax in either country with a view to provide relief under double taxation.

c) Exchange of information on evasion or avoidance of Income-tax or investigation in latter cases.

d) For recovery of Income-tax under either of the country laws.

Although treaties entered into by various countries are unique, a certain amount of uniformity is desirable in its framework. With this end in view, the tax treaties either the Organisation of Economic Co-operation and Development (OECD) model or United Nations (UN) model of Double Taxation Convention between developed and developing countries 1980. Most of the Indian treaties are based on the former. The agreements in turn can also be categorised into-

(a) limited agreements and

(b) comprehensive agreements

Limited agreements are generally entered into to avoid double taxation relating to income derived from operation of aircrafts, ships, carriage of cargo and freight. On the other hand, comprehensive agreements are very elaborate documents, which lay down in detail how income under various heads may have to be dealt with. Limits under various heads like income from immovable property, capital gains, dividends, interests, royalties, fees for technical services, etc and the manner of taxing the same are generally laid down in the comprehensive agreements. Some the agreements provide for taxation of annuities and pensions.

Section 91 of the Income Tax Act deals with the double taxation reliefs in respect of countries with which no agreement exists. The relief will be available subject to the following conditions satisfied:

1. The assessee in question must have been resident in the taxable territories.

2. That some income must have accrued or arisen to him outside the taxable territory during the previous year and it should India.

3. In respect of that income, the assessee must have paid by deduction or otherwise tax under the law in force in the foreign country in question in which the income outside India has arisen.

   If the above conditions are satisfied, the person would be entitled to relief from the Indian Income-tax payable by him on such doubly taxed income at the average Indian rate of tax or the average rate of tax of the said country, whichever is lower or at the Indian rate of tax, if both rules are equal. The average rate of tax means the tax payable on total income divided by the total income.

   In a landmark judgement, the Income-tax Appellate Tribunal has held that the Central Government cannot withdraw from the tax payer exemptions granted under DTAA with another country.

DTAA is discussed elsewhere.

FOREIGN COLLABORATION AGREEMENTS

The following may have to be borne in mind in entering into foreign collaboration agreements:

Choose the right country:

It is essential to choose the right country from where the investments must be made into the Indian country. Such choice would depend upon the effective rate of taxation in the hands of the foreign company on dividend income and income tax on capital gains. Similarly technology transfer should take place from a country where the effective rate of taxation on royalty income / fees for technical services earned by the foreign company is the least. The right choice of the country can mitigate the tax burden to a large extent.

Tax credit:

DTAA provide for the tax credit in respect of taxes paid in the other country. Tax credit is normally a benefit, which accrues to the foreign collaborator and should be taken into account in fixing the consideration payable to the foreign collaborator. Generally treaties contain a provision that any tax credit received by the foreign collaborator would be passed on by him to his Indian counterpart.

Dependent services:

Generally, the salaries, wages and other remunerations received by the foreign

personnel deputed to India are not taxable if the period of stay does not exceed 181 days in a fiscal year. In case the period of stay is likely to exceed 181 days in a fiscal year, it may be worthwhile to spread the stay of the foreign technicians to 2 fiscal year so that it does not exceed 181 days in aggregate in a single fiscal year.

Royalty and technical service fees:

Royalty and technical service fees can be negotiated nett of Indian taxes. The Indian tax will than be separately paid by Indian party. The payment will however be towards meeting the foreign parties Indian tax liability. The tax so paid by the Indian party is not treated as Indian income in the hands of the foreign party. This has the effect of some tax saving.

The hypothetical tax situation may be illustrated with the help of DTAA with Denmark on royalty fees:

Tax paid on gross basis	5%
Tax on 20% of 5%	1%
Net remittance	4%
Taxes on net basis	4.165%
Tax at 20% of 4.165%	0.833%
Net remittance	4.165%

Thus there is an advantage of 0.165% to the foreign company while the Indian company pays only 5% tax. This situation has arisen because there no tax on tax paid in respect of royalties and technical service fees under section 10(6A).In both the situations, the Foreign company would be eligible for a credit of Indian tax against its foreign tax liability. The aforesaid exercise may not be worthwhile, if the foreign company is able to take full advantage of tax credit abroad for the tax paid in India.

Split up of total consideration payable to foreign party:

In respect of many treaties, different rates are provided for royalty and technical service fees. For example under the DTAA with some country, royalty is taxed at 10% of the gross sum and the technical service fees are taxed at 20% of the gross sum. In such a situation it would be advantageous to split up the consideration into royalty and technical service fees and maximum consideration should be attributed to either royalty or technical service fees, whichever is taxed at a lower rate.

Take advantages of the examples given in the treaty:

The examples given in the treaty entered into with United States offer an excellent medium for tax planning. These examples draw distinction between situations where may be taxed as fees for included services and those situations where it may not be so taxed. The agreements may be drafted in such a manner so as not to include the services within the purview of fees for included services.

Tax sparing:

Tax spearing provisions in the treaties should be carefully considered. For instance, in the treaty with Japan, the credit with respect of interest income will be provided not only for tax paid in Indian but also for tax spared u/s 10(15)(iv) of the Income- tax Act as per agreement between the two Governments vide Article 23 of the convention. Similarly, as per paragraph 3(b) of Article 23 of the Convention with Japan, Japanese taxpayer deriving dividend income from an Indian company in which the Japanese taxpayer owns not less than 25% of the voting share capital, will be eligible for credit against Japanese tax not only in respect of 15% tax paid on dividend income, but also for Indian tax payable by the company paying dividend in respect of its income.

Render services outside India to save tax:

In some treaties like that with Austria technical services fees would be taxed in India if the activities were performed in India. In such cases, the parties to the agreement may consider rendering of technical services outside India.

Royalty vis-a-vis business profits:

In many countries, the definition of royalties is narrower than the definition in the Indian Income-tax Act and this may have a bearing on the tax liability of the foreign enterprise providing technical know-how. The tax liability in India may be avoided, for instance, in respect of

payments received by say a UK enterprise if the payment is not in the nature of royalty as per the definition of the DTAA although it may be so under the Indian Income-tax Act. For instance lumpsum payment for transfer of technical know-how package abroad may not constitute royalty as per the DTAA. The same may be taxed as business profit I the UK enterprise has a PE in India. In case it does not so have, it would not be taxed in India. The Calcutta High Court in CIT Vs Davy Ashmore India Ltd. (1991) 190 ITR 62 has held that where there is an outright purchase or sale as per the DTAA between India and UK, the consideration is for the transfer of such designs, secret formula, etc and cannot be treated as royalty.

Presumptive tax:

There are provisions in the Indian Income-tax Act pertaining to presumptive taxation like section 44B, 44BB, 44BBA and 44BBB. The same may be advantageous vis-à-vis getting the business income taxed on the basis of income less expenses. The foreign parties should take advantage of such provisions. It may be mentioned that as per section 90 of Income-tax Act, the provisions of the Treaty or the normal provisions of the lncome-tax Act, whichever is more beneficial would be applicable to the foreign party:

Improvements provided free of cost:

In case the foreign technical cum financial collaboration agreement with a foreign party provides for making available updates free of cost, it is advisable to show in the agreement that in consideration of providing free updates, equity shares are being issued to the foreign party. This would enable the foreign party to claim the cost of updates as part of the cost acquisition of equity shares and may enable the foreign party to mitigate tax on capital gains in the event of sale of shares. It is advisable that the agreement should provide for such free updates only for a limited period.

Accommodation/ living expenses for technicians:

It is advisable to provide in the agreement that the accommodation and living expenses the foreign technicians deputed should be met by the Indian company.The same would be taxable in India because of:

a) There is no employer - employee relationship and there is no question of taxing perquisite u/s 9(I)(ii) of the Act [ITAT Hyderabad Bench in Flores Gonther Others Vs ITO 29 TTJ 392.]

b) If it is assumed that such benefits accrue to the foreign technicians by virtue of contract of service entered into by them with the foreign collaborators, the same would be exempt u/s 10(14) if the Income-tax Act [CIT Vs D S Blackwood (1989) 178 ITR 470 (Cal); ITO Vs R T Lowerance 15 lTD 490 (All) and E Bettelli Vs ITO (1986) 26 TTJ 96 (Ahd)).

E-Commerce and Taxation:

In the era of e-commerce, the determination of the place of source with reference to an item of income may quite often pose difficulty. The source-based taxation of business income depends on physical presence in the form of fixed place of business or a dependent agent in the source country. With e-commerce the need for physical presence virtually ceases. The change in mode of delivery from physical to online raises characterization issues and the lack of physical presence also creates problems in enforcement of tax laws. Therefore the long-term solution of the problems created by characterization lies in making direct taxation identical for all streams of income in a manner aimed at ensuring equitable sharing of revenues between residence country and source country. The following rulings by the Authority for Advanced Ruling may be worth remembering in this context:

1. A company incorporated in Mauritius for sale and distribution of television channels enters into an agreement with an Indian company where under the latter would solicit orders from purchasers of airtime and pass on those orders to the former. The business profits earned by the Mauritian company through Indian company are profits deemed to accrue or arise in India u/s 9 of the Act. However by virtue of Article 7 of the DTAA between India and Mauritius, they are not liable to be taxed in India, if:
   a) The liability of the Mauritian company to pay tax in Mauritius was established and
   b) The Mauritian company and not the Indian company is shown to exercise generally the power to conclude the advertisement contract for sale of airtime
   - P No. 296 of 1996 T V M Vs CIT 237 ITR 230 (AAR).

2. An American company is engaged in providing international credit cards, travelers cheques and travel related services. It has Central Processing Unit (CPU) in USA and Consolidated Data Network (CDN) in Hong Kong. Indian company is given access to the CPU through CDN for the reporting and processing of information on travel by customers in India. Charges for the use of CPU and CDN of American company paid by Indian company is royalty for the case of 'design or model ,plan secret formula and process' and therefore taxable in India under Article 12(3)(a) of DTAA between India and USA – p. no. 30 of 1999 238 ITR 296 (AAR).

3. Where there is a PE for a non resident income attributable to such PE is chargeable to tax in the country in which such PE exist – p. no.28 of 1999 242 ITR 208 (AAR). A foreign company having a fixed office will be constructed to have a PE-p. no.13 of 1995 228 ITR 487 (AAR).

TAX ASPECTS OF MERGERS AND AMALGAMATIONS

The business and economic environment has thrown up the need for rationalization of laws relating to business reorganization for restructuring of production system and better utilization of resources, which have become necessary with a view to enabling the Indian industry to rearrange itself to become globally competitive. It was in this background that tax concessions to conversation of proprietary/partnership concerns into company were provided for in the Finance Act, 1998.the Act now provides for tax concessions in the following cases of business reorganization.

1. Amalgamation / merger of companies.

2. Conversation of proprietary concern / firm in to a company.

3. De-merger of a company.

4. Slump sale.

Merger is a combination of two or more companies into one company and may involve either absorption or consolidation. Where the assets and liabilities of one company are taken over by another and former losses its identity, it is referred to as absorption, for e.g.TOMCO with HLL, RPL with RIL, etc. In case a new company comes into existence and the participating companies go out of existence, the re-arrangement is known as amalgamation, e.g. Renusager with Hindalco.

Examples for the amalgamation / consolidation variety include the merger of Tetrapack and Alfalaval to form Tetralaval. In merger transactions, the consideration is paid for and received in shares and both the merging partners receive money in future in the form of dividends / yields. No money transaction is usually implied at the time of entering into a merger agreement. Whether the share capital is pooled or assets are pooled, so long as a share for share exchange takes place between the contracting parties, the transaction is merger. In an acquisition, the consideration is in the form of cash. The person or the corporation intending the control another corporation pays cash for number of shares that give the controlling interest. Thus the seller of the shares receives money in the current period of the transaction and the buyer of the shares also pays in today's values.

The de-merger signifies spinning-off or hiving-off the existing divisions of the company into a separate company. Therefore the de-merger means a split or division of the company. The division hived off could be transferred to a new company or it could be sold to an existing company. A de-merger takes place in the cases of internal restructuring or family settlements or in cases of tax planning. For example, in settlement of disputes between Ambani brothers de-merger of Reliance Industries Ltd. (RIL) took place and companies like Reliance Communications Ltd; Reliance Natural Resources Limited; etc. were demerged and shareholders of the RIL received free of cost, shares in the demerged companies.

The slump sale refers to the sale of the undertaking as a going concern. In this case, the consideration is not fixed for each and every asset separately and a lump sum consideration is arrived at for the undertaking as a whole.

The term amalgamation has not been defined u / s 394 of the Companies Act and various judicial decisions points to the meaning of term. The amalgamation under the company law may be pursuant to a court order or under an order of the central Government, if it is in the public interest.

The term 'amalgamation' has been defined u / s 2(1B) of the income-tax Act and if the amalgamated company wishes to the set off the losses and unabsorbed depreciation of the amalgamating company with its profits, the condition laid down u / s 72A of the Act shall have to be complied with. For amalgamation of banking companies, provisions are made u / s. 72AA.

In order that an amalgamation may fall under section 2(1B) of the Income-tax Act, the following conditions must necessarily be fulfilled:

1. All the property of the amalgamating company should be vested in the amalgamated company.

2. All the liabilities of the amalgamating company should become the liabilities of the amalgamated company.

3. Shareholders holding not less than 3/4th in the value of the share in the amalgamating company should become the shareholders of the amalgamated company. However the shares already held by or its subsidiary immediately before the amalgamation shall be excluded.

In the following cases the merger will not be called an amalgamation:

a. Where the property of the company say 'A', which merges is sold to the other company say 'B' and the amalgamation comes about by virtue of a transaction of sale. This is to exclude from amalgamation, the cases where the amalgamation scheme is not approved by the High Court;

b. Where the company 'A' which is wound up in liquidation and the Liquidator distributes the property of company 'A' to the company 'B' and the amalgamated company 'B' receives the property of the company 'A' (the amalgamating company) from the liquidator as on liquidation.

The amalgamated company is entitled to carry forward the unabsorbed depreciation and brought forward loss of the amalgamating company provided the following conditions are fulfilled (S. 72A):

1. The amalgamation should be of

(a) *a company owning an industrial undertaking or a ship or a hotel with another company; or*

(b) *a banking company referred to in clause* (c) *of section 5 of the Banking Regulation Act, 1949 with a specified bank; or*

(c) *one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business,*

2. *If the above conditions are satisfied then, (i) the accumulated loss and (ii) the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected. The amalgamated company shall set off and carry forward of loss and unabsorbed depreciation. For the purpose of carry forward, year of amalgamation shall be considered to be the year of origination.*

3. The benefit of *set off and carry forward of loss and unabsorbed depreciation is not allowed if the following further conditions are not complied with [s. 72A(2)]:*

(*a*) the amalgamating company—

(*i*) has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;

(*ii*) has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation;

(*b*) the amalgamated company—

(*i*) holds continuously for a at least of five years from the date of amalgamation at least three-fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;

(*ii*) continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation;

(*iii*) fulfils such other conditions as may be prescribed.

4. In a case where any of the conditions laid down in section 72A (2) are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.

Tax concessions/Incentives in the case of amalgamation

If any amalgamation takes place within the meaning of the section 2(1B) of the Income-tax Act, the following tax concessions are available:

I.Tax concessions to amalgamating company.

II. Tax Concessions to the shareholders of the amalgamating company.

III. Tax concessions to the amalgamated company.

I.Tax concessions to the amalgamating company.

a. Capital gains tax is not attracted as section 47(iv) exempts from capital gains tax liability in case of any transfer of capital assets in a scheme of amalgamation of the amalgamating company to the amalgamated company provided the amalgamated company is an Indian company.

b. Even if there is a transfer of any asset by an amalgamating company for inadequate consideration in the scheme of amalgamation, no tax implications exist.

c. Tax concessions to a foreign amalgamating company – Where a foreign company holds any shares in an Indian company and transfers the same in the scheme of amalgamation to another foreign company, such transactions will not be regarded as transfer for the purpose of capital gain u/s 45 of the Income-Tax Act if the following conditions are satisfied:

1. Atleast 25% of the shareholders of the amalgamating foreign company should continue as shareholders of the amalgamated foreign company and,

2. Such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated.

II.Tax concessions to the shareholders of an amalgamating company.

Where a shareholder of an amalgamating company transfers his shares in a scheme of amalgamation, such transactions will not be regarded as a transfer for capital gain purpose if the following conditions are satisfied:

a. The transfer of shares is made in consideration of the allotment to him of any share or shares in the amalgamated company, and

b. The amalgamated company is an Indian company.

The cost of acquisition of such assets of shares in the amalgamated company shall be the cost of acquisition of shares in the amalgamating company and for computing the period of holding of such shares, the period for which such shares were held in the amalgamating company shall also be included.

III. Tax concessions to the amalgamated company.

The amalgamated company shall be eligible for tax concessions provided the amalgamation satisfies all the three laid down in section 2(1B) and the amalgamated company is an Indian company. Subject to the above, the amalgamated company shall be eligible for following tax concessions:

1) Expenditure on scientific research [Sec 35(5)] –

Any unabsorbed capital expenditure will be allowed to be carried forward and set off in the hands of the amalgamated company. Further if such asset ceases to be used in a previous year for scientific research related to the business of the amalgamated company and the amalgamated company sells such assets, the sale price to the extent of the cost of the asset shall be treated as business income of the amalgamated company. The excess of the sale price over the cost of the asset shall be subject to the provisions of the capital gains.

2) Expenditure for obtaining licence to operate telecommunication services [Sec 35 ABB (6)]

Where in a scheme of amalgamation, the amalgamating company sells or otherwise transfers its licence to the amalgamated company (being an Indian company) the provisions of section 35ABB become applicable in the same manner to the amalgamated company and consequently the expenditure on acquisition of licence not yet written off shall be allowed to the amalgamated company in the same number of balance instalments and where such licence is sold by the amalgamated company, the treatment of the deficiency / surplus will be same as would have been in the case of amalgamating company.

3) Treatment of preliminary expenses [Sec 35D (5)] –

The amount of preliminary expenses of the amalgamating company to the extent not written off shall be allowed as a deduction to the amalgamated company.

4) Amortization of expenses in case of amalgamation [Sec 35DD] - One- fifth of the expenditure on amalgamation shall be allowed for each of the 5 successive previous years beginning with the pre vious year in which the amalgamation or de-merger takes place. No deduction shall be allowed for this expenditure under any other provisions of the Act. This is subject to the rider that the expenditure is incurred in the process of running the business or remaining in business.

5) Treatment of expenditure on prospecting, etc of certain minerals [Sec 35E (7A)] –

The amount of expenditure on prospecting, etc of certain minerals of the amalgamating company, which is not yet written off, shall be allowed as deduction to the amalgamated company as it would have been to the amalgamating company.

6) Treatment of capital expenditure on family planning [Sec 36(1) (ix)] –

Where in a scheme of amalgamation a capital expenditure is transferred to an amalgamated company, such transfer shall not be regarded as transfer and the capital expenditure on family planning not yet written off shall be allowed to the amalgamated company in the same number of balance instalments and where such assets are sold by the amalgamated company, the treatment of the deficiency / surplus will be the same as would have been in the case of the amalgamated company.

7) Treatment of bad debts [Sec 36(1) (vii)] –

The debt of the company taken over by the amalgamated company in a scheme of amalgamation shall be allowed to be written off as bad debts of the amalgamated company if it turns bad [CIT Vs T Veerabhadra Rao, K. Koteswara Rao & Co. 155 ITR 152 (SC)].

8) Carry forward and set off of business losses unabsorbed depreciation –

The amalgamated company shall be allowed to carry forward and set off the business losses and unabsorbed depreciation of the amalgamating company if all the conditions laid u / s 72A are satisfied.

9) In case of no depreciable assets transferred by an amalgamating company to an Indian amalgamated company, the cost of acquisition of the asset shall be taken at the same value as it was to the original owner duly adjusted for any cost of improvement [Sec 45]. In the case of depreciable assets, it would be transferred at WDV of the assets in the case of amalgamating company for the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said preceding previous year. The provisions of section 50 regarding computation of capital gains would apply.

10) The benefit of tax concession is allowed to the amalgamating company and the amalgamated company only when the conditions laid down in section 2 (1B) of the Act. Amalgamation, in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that —

(i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;

(ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;

(iii) shareholders holding not less than three-fourths in value of the shares in the amalgamating company or companies, other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary become shareholders of the amalgamated company by virtue of the amalgamation,

otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first-mentioned company.

11) As per section 72A, the amalgamated company can carry forward the business loss and unabsorbed depreciation of the amalgamating company subject to certain conditions. Where it is not possible to satisfy such conditions, the companies may opt for a reverse merger i.e. instead of the loss making company merging with the profit making company, the profit making company may merge with loss making company. In this case the amalgamated company which was the loss making company will be able to carry forward its own business loss and unabsorbed depreciation and set it off against the profits of the business which has merged in the scheme of amalgamation.

12) The benefit u / s 47(vii) shall be allowed only when the shareholders of the amalgamating company are allowed shares of the Indian amalgamated company in lieu of shares held by them in the amalgamating company. If the shareholders are allotted something more than the shares in the amalgamated company i.e. bonds, debenture, etc no benefit will be available u / s 47 (vii).

Slump Sale

According to Section 2(42C) defines Slump Sale as slump sale means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. The determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees, etc, shall not be regarded as assignment of values of individual assets and liabilities.

Any profits or gains arising from the slump sale affected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

Provided that any profits or gains arising from the transfer under the slump sale of any capital asset being one or more undertakings owned and held by an assessee for not more than thirty-six months immediately preceding the date of its transfer shall be deemed to be the capital gains arising from the transfer of short-term capital assets. The "net worth" of the undertaking or division so transferred shall be deemed to be the cost of acquisition and the cost of improvement in computing the capital gain. However, indexation benefit shall not be allowed.

"Net worth" shall be the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in its books of accounts. Any change in the value of assets on account of revaluation of assets shall be ignored for the purposes of computing the net worth.

For computing the net worth, the aggregate value of total assets shall be –

(a) in the case of depreciable assets, the written down value of the block of assets determined in accordance with the provisions contained in section 43 (6); and

(b) in the case of other assets, the book value of such assets.

A report of a Chartered Accountant indicating the computation of the net worth and certifying the correctness of net worth is required to be enclosed along with the return of income.

The following are the advantages u/s 50B-

i. If the undertaking is in existence for more than 36 months, the gain arising on slump sale is treated as long term even though some of the assets comprised in the undertaking may be held only for few months.

ii. If the gain is long term it will suffer only 20% tax rate u/s 112.

iii. No distinction is made between depreciable and non- depreciable assets.

iv. It is possible to plan for exemption under the various applicable sections such as 54EC, 54ED or 54F if the undertaking is long term capital asset.

The only disadvantage u/s 50B appears to be the denial of indexation benefit respect of non-depreciable long term capital assets comprised in the business.

An assessee may have to weigh the options of selling a business as a going concern by way of slump sale or alternatively, selling the assets independently and decide about the advantageous mode of transferring the business keeping in view the above aspects discussed.

EXEMPTIONS, DEDUCTIONS AND REBATES

Exclusions/Exemptions

Income not included in Total Income of any person (Section 10)

A. By Character of Income:

1. Agricultural income is totally exempt provided it falls within the definition of 'agricultural income' [section 2(1A)]. However the agricultural income is to be aggregated in the case of certain assessees for the purpose of determining the rate of tax on non-agricultural income.

2. Any subsidy received from or through the Tea Board under any such scheme for re-plantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for tea cultivation as the Central Government may notify.[Section 10(30)]

3. Any subsidy received from or through the concerned board under any such scheme for re-plantation or replacement of rubber plants, coffee plants, cardamom plants or plants for the growing of such other commodity or for rejuvenation or consolidation of areas used for cultivation of rubber, coffee, cardamom, or such other commodity as the Central Government may notify. [Section 10(31)].

B. By Character of receipt:

1. Any payment made in cash or in kind as an award instituted in the public interest by Central or State Government or any other body and approved by the Central Government or as a reward by the Central Government or any State Government for such purposes as may be approved by the Central Government in the public interest. [Section 10(17A)]

2. Any payments made under Bhopal gas leak disaster (processing of claims) Act, 1985 to the extent that it has not been allowed as deduction on account of any loss or damage caused to him by such disaster. [Section 10(10BB)]

3. The tax on income earned in the business of leasing operation of aircrafts by a Government of a foreign state or foreign enterprise through an Indian company. [Section 10(6BB)]

4. Any income by way of fees for technical services under an approved agreement in projects connected with security of India for providing services in or outside India.

5. Any allowance or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering services outside India. [Section 10(7)]

6. The remuneration received by an individual from the Government of a foreign state for carrying out assigned duties in India under any cooperative technical assistance programme or in projects in accordance with approved agreements or any other income which accrues or arises outside India and is not deemed to accrue or arise in India in respect of which such individual is required to pay any income or social security tax to the Government of that foreign state. [section 10(6)(xi)]

7. Any remuneration or fees received by a consultant out of the funds made available to an international organization under a technical assistance grant agreement between such international organization and the Government of the foreign state or any other income which accrues or arises outside India and is not deemed to accrue or arise in India in respect of which such individual is required to pay any income or social security tax to the Government of that foreign state.[Section 10(8A)]

8. Any remuneration received by him as an employee of a foreign enterprise for services rendered by him during his stay in India, under section 10(6)(vi), provided the following conditions are fulfilled –

   (a) the foreign enterprise is not engaged in any trade or business in India.

   (b) his stay in India does not exceed in the aggregate a period of ninety days in such previous year.

   (c) such remuneration is not liable to be deducted from the income of the employer chargeable under the Income Tax Act.

C. By Category of Assessees

1. Salaried Employees

A. General

1. Scholarship granted to meet the cost of education is exempt. [Section 10(16)]

2. Any special allowance or benefit, not being in the nature of a perquisite within the meaning of clause (2) of section 17, specifically granted to meet expenses wholly, necessarily and exclusively incurred in the performance of the duties of an office or employment of profit to the extent to which such expenses are actually incurred for that purpose. [Section 10(14)(i)]

3. Any prescribed allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at the place where he ordinarily resides or to compensate him for the increased cost of living is exempt upto the prescribed extent. [Section 10(14)(ii)]

4. Any income received by any person on behalf of any Regimental Fund or Non-Public Fund established by the armed forces of the Union for the welfare of the past and present members of such forces or their dependants.[Section 10(23AA)]

5. Where the contract of employment provides for encashment of unutilized leave at the time of retirement, exemption is available to the extent of the least of the following:

   (a) 30 days for every year of actual service rendered for the employer from whose service the employee has retired.

   (b) 10 months average salary.

   (c) Actual leave encashment at the time of retirement.[Section 10(AA)]

6. Retrenchment compensation to the extent of the least of the following:[10(10B)]

   (a) 15 days average pay for every completed year or part thereof of continuous service.

   (b) Rs.5,00,000.

   (c) Actual retrenchment compensation.

7. Commuted pension, where the employee has received gratuity, commuted value of one-third of the pension and in other cases. One-half of such pension is exempt. Any amount received in excess will be included in gross salary.

8. Any payment in computation of pension received by an individual from a fund set up by Life Insurance Corporation (LIC). [Section 10(23AAB)]

9. Any allowance granted for encouraging the academic research and training pursuits in educational and research institutions.

10. Any lumpsum payments received at the time of voluntary retirement from service, provided the employees fall under the prescribed categories and the payments were received under scheme evolved by the employers, which satisfied the prescribed guidelines

11. Gratuity received on the retirement or on incapacitation or on termination of his employment or on his death to the extent of the least of:

    (a) Actual amount of gratuity.

    (b) Half month's average salary for every completed year of service.

    (c) Rs.3, 50,000. [Section 10(10)]

Any amount in excess of the above received by an employee shall be included in his gross salary and received by the legal heirs under the head 'income from other sources'.

12. Lumpsum payment made gratuitously or by way of compensation or otherwise to the widow or other legal heirs of an employee, who dies while in service.

13. Any payment from a provident fund to which the Provident Funds Act 1925 applies or from any other provident fund set up by the Central Government under notification. Public provident fund scheme 1968 has been notified for the purpose.[Section 10(11)]

14. The accumulated balance due and becoming payable to an employee participating in a recognized provident fund to the extent provided in Rule 8 of Part A of the fourth schedule. [Section 10(12)]

15. Any payment from an approved superannuation fund made on the death of a beneficiary or paid in lieu of or in computation of an annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement or by way of refund of contribution to or on the death of a beneficiary or by way of refund of contribution to an employee on his leaving the service in connection with which the funds is established otherwise than by retirement to the extent to which such payment does not exceed the contributions made prior to the commencement of this Act and the interest thereon. [Section 10(13)]

16. Any sum received under a life insurance policy including the sum allocated by way of bonus on such policies, other than-

(a) any sum received under sub-section (3) of section 80DD or sub-section (3) of section 80DDA; or

(b) any sum received under a Keyman insurance policy; or

(c) any sum received under an insurance policy issued on or after the 1st day of April, 2003 in respect of which the premium payable for any of the years during the term of the policy exceeds twenty per cent of the actual capital sum assured [Section 10(10D)]

17. Provision of refreshments during office hours in the office premises.

18. Tea or other non-alcoholic beverages and light snacks during working hours

19. Free supply of gas, electric energy or water for household consumption by the employer without purchasing them from any other outside agency.

20. Any free educational facilities to the employees or their children.

21. Allowance given to an employee to meet the expenses in connection with rent of the accommodation which the employee might have to take to the extent of the least of the following:

    (a) Actual house rent allowance paid in respect of the period during which the rented accommodation is occupied during the previous year.

    (b) Excess of rent paid over 10% of the salary for the relevant period

    (c) 50% of the salary in case the accommodation is in Mumbai. Kolkata, Delhi or Chennai and 40% in other cases. [Section 10(13A)]

22. Transport facility provided by a transport undertaking engaged in the carriage of goods or passengers to its employees and dependent family members.

B. Foreigner/non-residents:

1. The remuneration received by him as an official, by whatever name called, of an embassy, high commission, legation, commission, consulate or the trade representation of a Foreign State, or as a member of the staff of any of these officials, for service in such capacity. [Section 10(6)(ii)]

2. Remuneration received from a foreign enterprise for services rendered during his stay in India provided the stay does not extend beyond 90 days and such remuneration is not liable to be deducted from the income of the employer chargeable under Income Tax Act.[Section 10(6)(vi)]

3. Salary received by an individual, being a non-resident employed on a foreign ship provided the stay does not extend beyond 90 days.

4. Any tax paid by the employer to the Central Government on the salaries paid for a period not exceeding 48 months from the date of his arrival in India provided that he is on the service of Government or Local Authority or any corporation set up in India under any special law or any such institution or body established in India for carrying on scientific research as is approved for the purpose or in any business carried on in India. This exemption is also applicable to an individual who is a non resident Indian citizen.

C. Government employees and employees of Local Authority

1. The entire amount of death cum retirement gratuity paid under the revised pension rules of the Central Government or the Central Civil Services (Pension) Rules. 1972 or any other similar scheme applicable to members of the civil services of the Union or the holders of posts connected with defence or of civil post under the Union or the members of all India services or the members of the civil services of the State or the holders of civil post under a State or the employees of a Local Authority or the pension code or regulations applicable to the members of the defence services.

2. Commuted pension received under civil pensions commutation rules of the Central Government or under any similar scheme applicable. Judges of the Supreme Court and High Court will be entitled to exemption of the commuted portion under section 10(10A)(i).

2. Partnership Firms

In the case of a partner, the share in the total income of the firm shall be exempt, if the firm were to be assessed to tax separately. [Section 10(2A)]

3. Hindu Undivided Family

Any sum received by an individual as a member of a HUF shall be exempt in the hands of the member provided such sum has been received out of the income of the family or in the case of any impartible estate such sum has been paid out of the income of the estate belonging to the family. [Section 10(2)]

The exemption is restricted to the members of the family who have an interest in the joint income of the property and does not extend to their heirs. A daughter's son who as a prospective heir to the estate receives an allowance from the income of the estate does not receive it as a member of the joint family. A widow who is a member of HUF and receives maintenance allowance out of the joint income of the family shall get exemption but if such allowance were to be paid not out of the income of the family, the same would not be exempt under section 10(2).

A married daughter is not a member of the family of her father or mother and any income received by such daughter or married widowed daughter staying with her parents is not entitled to exemption.

D. By Class of Organizations

1. Any income of a corporation established by a central / state / provincial Act or of any other body, institution or association wholly financed by the Government where such institution has been established or formed for promoting the interest of the members of the scheduled caste or scheduled tribes or backward classes or of any two or all of them. [Section 10(26B)]

2. Any income of a corporation established by the Central Government or any State Government for promoting the interests of the members of notified minority communities. The Central Government has since notified Muslims, Christians, Sikh Buddhists, Zoroastrians and Parsis as minority communities for the purpose of this section. [Section 10(26BB)]

3. Any income of a cooperative society formed for promoting the interest of the members of either the scheduled caste or the scheduled tribes or both referred in clause 26B on the condition that the membership of the cooperative society consists of only other cooperative societies formed for similar purposes and the finances of the society are provided by the Government and such other societies. [Section 10(27)]

4. Any income accruing or arising to the following boards / authorities:

   (a) The coffee board [section 4 of the Coffee Act, 1942].

   (b) The rubber board [section 4(1) of the Rubber Board Act, 1947]. \

   (c) The tea board [section 4 of the Tea Act, 1953].

   (d) The tobacco board [section 4 of the Tobacco Board Act, 1975].

   (e) The marine products export development authority [section 4 of the Marine Products Export Development Act, 1985].

   (f) The agricultural and processed food products export development authority [section 4 of the Agricultural and Processed Food Products Export Development Act, 1985].

   (g) The spice board [section 3(1) of the Spice Board Act, 1986]. [Section 10(29A)]

5. Any income of the employee's state insurance fund set up under the provisions of the Employees State Insurance Act, 1948. [Section 10(25A)]

6. Any income received by the trustees on behalf of a recognized provident fund or an approved superannuation fund or an approved gratuity fund. [Section 10(25)]

7. Interest on securities belonging to any provident fund (Covered by the Provident Funds Act, 1925) and any capital gains of the fund arising from the sale, exchange or transfer of such securities.

8. Any income received by the board of trustees constituted under the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948 on behalf of the deposit linked insurance fund constituted under that Act. [Section 10(25)]

9. Any income received by the board of trustees constituted under the Employees Provident Funds and Miscellaneous Provisions Act, 1952 on behalf of the deposit linked insurance fund constituted under the Act. [Section 10(25)]

10. The income from house property and income from other sources of a registered trade union within the meaning of the Indian Trade Unions Act, 1926 or an association of such trade unions formed primarily for the purpose of regulating the relations between workmen and the employers and / or between workmen inter Se. [Section 10(24)]

11. Income from dividends, interests, and long-term capital gains of an infrastructure capital fund or an infrastructure capital company or a cooperative bank provided:

    (a) Such income is on account of the investment made on or after 01-06-1998.

    (b) Investment is by way of shares or long-term finance in any enterprise wholly engaged in the business referred to in section 80-lA (4) or a housing project referred to in section 80-lB (10) and such enterprise is approved by the Central Government.

12. Income of a venture capital company or a venture capital fund registered under Securities and Exchange Board of India Act, 1992 (ESBI) from any investments made in a venture capital undertaking.

13. Any income of investor protection fund set up by the recognized stock exchanges in India either jointly or separately as the Central Government by notification in the official gazette specifies. [Section 10(23EA)]

14. Any income of Exchange Risk Administration Fund set up by public financial institutions either jointly or separately as the Central Government may by notification in the Official Gazette specify in this behalf. The fund set up by IDBI, IFCI, ICICI, PFCI and IREDA are exempt.

15. Any income received by any person on behalf of the following funds:

    (a) The Prime Minister's National Relief Fund.

(b) The Prime Minister's Fund (promotion of folk art) or

(c) The Prime Mister's Aid to Students Fund or

(d) The National foundation for communal harmony or

(e) Any university or other educational institution existing solely by / for educational purposes and not for purpose of profit or

(f) Any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or during convalescence or requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purpose of profit. [Section 10(23C)]

16. Income of the Insurance Regulatory and Development Authority (IRDA) established under section 3(1) of the Insurance regulatory and development authority Act, 1999. [Section 10(23BBE)]

17. Any income of the European Economic Community (EEC) derived in India by way of interests, dividends or capital gains from investments made out of its funds under such schemes as may be notified by the Central Government. The European Community International Institutional Partners (ECIIP) scheme 1993 has since been notified. [Section 10(23BBB)]

18. Any income of any body or authority established, constituted or appointed by or under any Central or Provincial Act to provide for the administration of any public, religious, charitable trust or endowments (including mutts), temples, gurudwaras, wakfs, churches or other places of public religious worship or societies for religious or charitable purposes. [Section 10(23BBA)]

19. Income of Khadi and Village Industries Board established in a State by or under a State or provincial Act for the development of khadi or village industries in the state. [Section 10(23B)]

20. Any income received by any person on behalf of a fund established for the welfare of employees or their dependents as may be notified in the Official Gazette and of which such employees are members subject to certain conditions.[Section 10(23AAA)]

21. Any income received by the person on behalf of any regimental fund or non-public fund established by the armed forces of the Union for the welfare of the past and the present members of such forces or their dependents.[Section 10(23AA)]

22. Income of the notified sports associations or institutions established in India with their object of controlling, supervising, regulating or encouragement of the games of cricket, hockey, football, tennis or other such games or sports specified by the Government.

23. Any income of such news agency set up in India solely for collection and distribution of news as the Central Government may notify in this behalf. Press Trust of India Limited, New Delhi and United News Agency of India have since been notified.

24. Income of a local authority falling under the heads 'income from house property', 'capital gains', 'income from other sources' or 'income from a trade or business' carried on by it which accrues or arises from the supply of a commodity or service (not being water or electricity) within its jurisdictional area or income from the supply of water or electricity within or outside its jurisdictional area. [Section 10(20)]

25. Any income of an authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages or for both. A state industrial corporation is entitled to exemption in the same way as a state housing board, development boards and similar authorities.

26. Income of a scientific research association, which is approved for the purpose of section 35(l)(ii), subject to the fulfillment of conditions. The property and income of a State shall be exempt from Indian taxation [Article 289(1)1. 35. The RBI is not liable to pay Income-tax as per section 48(1) of the Reserve Bank of India Act, 1934. [Section 10(21)]

27. UTI is not liable to pay Income-tax as per section 32(l)(a) of the Unit Trust of India Act, 1963.

28. The Oil industry development board is not liable to pay any Income-tax on its income, profits or gains as per section 22 of the Oil industry development Act, 1974.

29. The salaries, pension, etc of the officials of the United Nations are exempt from tax by virtue of section 2 of the United Nations (Privileges and immunities) Act, 1947 read with section 18(b) of Article 5 of the Schedule thereto. Pension received by the erstwhile employee of the WHO shall also be exempt.

30. The income of the banking service commission is exempt under section 27 of the Banking Service Commission Act, 1984.

31. The income of the IDBI is exempt under section 35 of the IDBI Act.

32. The income of SEBI is exempt under section 25 of the SEBI Act, 1992.

33. Income of IFCI Is exempt under section 6(1)of the Industrial Financial Corporation (Transfer of undertakings and repeal) Act, 1993.

34. The income of the Telecom Regulatory Authority of India (TRAI) is exempt under section 22 of the Telecom Regulatory Authority of India Limited Act, 1997.

E. By Character of Receipt

1. Any income, by way of interest on such securities or bonds as the Central Government may notify, earned by an assessee, who is non-resident in India. [Section 10(4)(i)]

2. Any income by way of premium on the redemption of bonds in respect of securities mentioned in (1) above. [Section 10(4)(i)]

3. Any interest earned on NRE deposits from banks in India.

4. The daily allowances to Members of Parliament or Legislative Assembly or any committee thereof and any allowance paid to Member f Parliament under Members of Parliament (Constituency allowance) Rules, 1986 and any allowance not exceeding Rs. 2000 per month in the aggregate received by any member of the Legislative Assembly or any committee thereof, which the Central Government may notify. [Section 10(17)]

5. Income of a minor child upto Rs. 1500 per child will be exempt in full. [Section 10(32)]

Relief when salary, etc., is paid in arrears or in advance (section 89).

Where an assessee is in receipt of a sum in the nature of salary, being paid in arrears or in advance or is in receipt, in any one financial year, of salary for more than twelve months or a payment which under the provisions of clause (3) of section 17 is a profit in lieu of salary, or is in receipt of a sum in the nature of family pension as defined in the Explanation to clause (iia) of section 57, being paid in arrears, due to which his total income is assessed at a rate higher than that at which it would otherwise have been assessed, the Assessing Officer shall, on an application made to him in this behalf, grant such relief as may be prescribed.

Share of member of an association of persons or body of individuals in the income of the association or body.

Where the assessee is a member of an association of persons or body of individuals being other than a company or any society registered under any law in force in any part of India, income-tax shall not be payable by the assessee in respect of his share in the income of the association or body computed in the manner provided in section 67A (Section 86)

Rebate in respect of securities transaction tax.

Where the total income of an assessee in a previous year includes any income, chargeable under the head “Profits and gains of business or profession”, arising from taxable securities transactions, he shall be entitled to a deduction, from the amount of income-tax on such income arising from such transactions, computed in the prescribed manner, of an amount equal to the securities transaction tax paid by him in respect of the taxable securities transactions entered into in the course of his business.

However, from A.Y. 2009-10, this rebate is withdrawn and instead, deduction for the securities transaction tax paid is allowed.

Carry forward set off of losses

Every dark cloud has a silver edge! Well, even sustaining a loss. Because, the Act allows set off of loss against other income either of the same year or for the succeeding years. The Act has made detailed provisions for the law governing carry forward and set off of losses and certain allowances.

The law in this behalf should be carefully studied while tax planning, as set off of loss saves tax and if opportunity is lost, it costs to the enterprise, in a sense that opportunity of tax saving is forfeited.

LAW RELATING TO IS DISCUSSED IN THE FOLLOWING TOPICS:

1. Set off of Loss in the Same Year
2. Carry forward and Set off of Loss in Subsequent Years
   (i) Basic Conditions for carry forward of loss.
   (ii) Conditions applicable to each head

As stated in section 14 of the Act computation of total income is made under certain heads viz.-

(i) Salaries

(ii) Income from House Property

(iii) Profits and gains of Business or Profession

(iv) Capital gains and

(v) Income from other sources.

In a case computation results in to a positive figure, it is income. Likewise, if the computation results into a negative figure, it is 'Loss". Therefore, there cannot be loss from the head 'Salary'. Loss can occasion from all the remaining heads.

SET OFF OF LOSS IN THE SAME YEAR

For the purpose of computing total income and charging tax thereon, income from various sources is classified under the following heads -

A. Salaries

B. Income from House Property

C. Profits and gains of Business or Profession

D. Capital gains

E. Income from other sources

These five heads of income are mutually exclusive. If any income falls under one head, it can-

not be considered under any other head. Income under each head has to be computed as per provisions under that head. Then, subject to provisions of Set off of Losses (Sec. 70 to Sec. 80) between the heads of income, the income under various heads has to be added to arrive at a gross total income. From this gross total income, deductions under chapter VIA are to be allowed to arrive at the total income.

In this part, the provisions relating to set off, carry forward and set off of losses are categorized as under-

SECTION 70

Where the net result for any Assessment Year in respect of any source falling under any head of income is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head.

(1) Save as otherwise provided in this Act, where the net result for any assessment year in respect of any source falling under any head of income, other than "Capital gains", is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head.

(2) Where the result of the computation made for any assessment year under sections 48 to 55 in respect of any short-term capital asset is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the assessment year in respect of any other capital asset.

(3) Where the result of the computation made for any assessment year under sections 48 to 55 in respect of any capital asset (other than a short-term capital asset) is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the assessment year in respect of any other capital asset not being a short-term capital asset.

Though the profits of each distinct business may have to be computed separately, the tax is chargeable, not on the separate income of each distinct business but on the aggregate of the profits of all the business carried on by the assessee. It follows from this that where the assessee carries on several businesses; he is entitled under section 70 to set off of losses in one business against profits in another - CIT v. P.M. Muthuraman Chettiar 44 ITR 710.

SECTION 71

Where the net result of the computation under any head of income in respect of any Assessment Year is a loss, the assessee shall be entitled to have such amount of loss set off against his income assessable for that Assessment Year under any other head of income.

Exceptions to provisions of sections 70 and 71 are as follows-

a) **Loss from speculation business**: "Speculation transaction" means a transaction in which a contract for the purchase or sale of any commodity including stocks and shares is periodically or ultimately settled otherwise than by actual delivery or transfer of the commodity or scripts. [Sec. 43(5)] Loss from speculative transaction, if it is in the nature of business, can be set off only against income of another speculative business.

b) **Loss under the head long term capital gains:** Loss under the head long term capital gains arising from transfer of long-term capital assets will be allowed to be set off only against long term capital gains.

Note: 1.Loss can be set off against deemed income.

2.Inter head adjustment is made only when the net income computed under a head is a loss.

3.The scheme of inter source and inter head adjustment is mandatory.

c) **Loss from owning and maintaining race horses** can be set off only against income of that activity.

d) No expenditure or allowance is allowed from wining from lotteries, crossword puzzles, card games etc. similarly, no loss from any lottery, card games, races, etc. is allowed to be set off from the income of such sources. [Sec. 58(4)].

e) Loss incurred by an assessee from a source, income from which is exempt cannot be set off against income from a taxable source.

f) Where the net result of the computation under the head "Profits and gains of business or profession" is a loss and the assessee has income assessable under the head "Salaries", the assessee shall not be entitled to have such loss set off against such income.

CARRY FORWARD AND SET OFF OF LOSS IN SUBSEQUENT YEARS

BASIC CONDITIONS FOR CARRY FORWARD OF LOSS.

SECTION 80: LOSS RETURNS.

In order to carry forward loss under section 72, 73, 74 and 74A, the due date is prescribed in section 139(1). No loss which has not been determined in pursuance of a return filed within the date in accordance with the provisions of section 139(3) shall be carried forward under the provisions of sec

The condition for filing of return in accordance with the provisions of sec. 139(3) shall not apply to loss from House Property carried forward u / s. 71B and unabsorbed depreciation u / s. 32(2).

Brought forward loss of earlier assessment Year in accordance with Ss. 72, 73, 74, 74A can be set off against the income of that Assessment Year and can be carried forward further, even if the return is not filed within the due date specified in section 139(1) of the Act.

CONDITIONS APPLICABLE TO EACH HEAD

71B.Carry forward and set off of loss from house property

Where for any assessment year the net result of computation under the head "Income from house property" is a loss to the assessee and such loss cannot be or is not wholly set off against income from any other head of income in accordance with the provisions of section 71 so much of the loss as has not been so set-off or where he has no income under any other head, the

whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year and –

(i) be set off against the income from house property assessable for that assessment year; and

(ii) the loss, if any, which has not been set off wholly, the amount of loss not so set off, shall be carried forward to the following assessment year, not being more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

Carry forward and set off of business losses (section 72)-

(1) Where for any assessment year, the net result of the computation under the head "Profits and gains of business or profession" is a loss to the assessee, not being a loss sustained in a speculation business, and such loss cannot be or is not wholly set off against income under any head of income in accordance with the provisions of section 71, so much of the loss as has not been so set off or, where he has no income under any other head, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and-

(i) it shall be set off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year;

(ii) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on.

Provided that where the whole or any part of such loss is sustained in any such business as is referred to in section 33B which is discontinued in the circumstances specified in that section, and, thereafter, at any time before the expiry of the period of three years referred to in that section, such business is re-established, reconstructed or revived by the assessee, so much of the loss as is attributable to such business shall be carried forward to the assessment year relevant to the previous year in which the business is so re-established, reconstructed or revived, and –

a) it shall be set off against the profits and gains, if any, of that business or any other business carried on by him and assessable for that assessment year; and

b) if the loss cannot be wholly so set off, the amount of loss not so set off shall, in case the business so re-established, reconstructed or revived continues to be carried on by the assessee, be carried forward to the following assessment year and so on for seven assessment years immediately succeeding.

(2) Where any allowance or part thereof is, under sub-section (2) of section 32 or sub-section (4) of section 35, to be carried forward, effect shall first be given to the provisions of this section.

(3) No loss [(other than the loss referred to in the proviso to sub-section (1) of this section)] shall be carried forward under this section for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

Losses in speculation business (section 73):-

(1) Any loss, computed in respect of a speculation business carried on by the assessee, shall not be set off except against profits and gains, if any, of another speculation business.

(2) Where for any assessment year any loss computed in respect of a speculation business has not been wholly set off under sub-section (1), so much of the loss as is not so set off or the whole loss where the assessee had no income from any other speculation business, shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and –

(i) it shall be set off against the profits and gains, if any, of any speculation business carried on by him assessable for that assessment year ; and

(ii) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on.

(3) In respect of allowance on account of depreciation or capital expenditure on scientific research, the provisions of sub-section (2) of section 72 shall apply in relation to speculation business as they apply in relation to any other business.

(4) No loss shall be carried forward under this section for more than four assessment years immediately succeeding the assessment year for which the loss was first computed.

Where any part of the business of a company other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources", or a company the principal business of which is the business of banking or the granting of loans and advances consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

Losses under the head "Capital gains" (section 74)

(1) Where in respect of any assessment year, the net result of the computation under the head "Capital gains" is a loss to the assessee, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and –

(a) in so far as such loss relates to a short-term capital asset, it shall be set off against income, if any, under the head "Capital gains" assessable for that assessment year in respect of any other capital asset;

(b) in so far as such loss relates to a long-term capital asset, it shall be set off against income, if any, under the head "Capital gains" assessable for that assessment year in respect of any other capital asset not being a short-term capital asset;

(c) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on.

(2) No loss shall be carried forward under this section for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

PROVISIONS RELATING TO CARRY FORWARD OF LOSSES

Carry forward of losses

Section	Nature of Loss	No. of Yeas	To be set off against
71B	Loss from house property	8 years	Income from house
72	Business loss unabsorbed	8 years	Income from business or profession
72A(1)	Accumulated loss and unabsorbed deprecation of an amalgamating company.	8 years from the expiry of amalgamation (set off in the year of amalgamation and carry forward for 8 years)	Business income of amalgamated company
72A(4)	Accumulated loss and unabsorbed deprecation of a demerged company.	Unexpired period out of total permissible period of 8 years.	Business income of resulting company.
72A(6)	Accumulated loss and unabsorbed deprecation or a proprietary concern.	8 years from the expiry of conversion of the firm or proprietary concern into a company.	Business income of successor company.
73	Speculation business loss.	4 years	Income from speculation business.
74	Loss under the head "Capital Gains"	8 years	Capital Gains.
74A	Loss under the activity of owing and maintaining racehorses.	4 years	Income from same activity.

Note: Under sub-section (1) of Section 72A, the loss and depreciation remaining unabsorbed in the case of amalgamating company shall be deemed as the loss or depreciation of the amalgamated company for the previous year in which the amalgamation is effected. Same analogy applies when a reorganization of the business is made where by a firm or proprietary concern is succeeded by a company as a contemplated under clause (xiii) or (xiv) of section 47. Consequently, apart from availing set off benefit in the year of amalgamation or reorganization, a fresh period of 8 years there after is available for carry forward and set off of unabsorbed loss / depreciation incase amalgamation or successor company. However, in case of demerger the

resulting company will get the benefit of carry forward and set off only for the remaining no. of years out of the total allowable 8 years.

SPECIAL PROVISIONS

Section 78(1):

Where a change has occurred in the constitution of the firm, the firm shall not be entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner remaining unabsorbed shall not be allowed to be carried forward by the firm. These restrictions shall not apply to unabsorbed depreciation.

Change in constitution of the firm takes place-

(i) If one or more of the partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change (provided the firm is not dissolved on the death of any of its partners).

(ii) Where all the partners continue with a change in their respective shares or in the shares or in the shares of some of them.

Section 78(2):

Where any person carrying on any Business or Profession has been succeeded in such capacity by another person otherwise than by inheritance, then the successor cannot have the loss of predecessor carried forward and set off against his income.

Section 79:

Losses (other than unabsorbed depreciation) in case of closely held company

In case of a company in which public are not substantially interested (defined in sec. 2(18) of the Act), the unabsorbed business loss relating to any Assessment Year can be carried forward and set off against the income in a subsequent Assessment Year only (if the shares of the company carrying not less than 51% of the voting power were beneficially held by the same persons) both on the last day of the Previous Year(s) in which the loss, claimed to be set off and on the last day of the Previous Year in which loss was incurred.

Exceptions

The provisions stated supra shall not apply if the change in the voting power takes place due to the following reasons-

a) the death of a shareholder; or

b) transfer of shares by way of gifts to any relative of the shareholder making such gift.

c) w.e.f. AY 2000-01, this section shall not apply to any change in the shareholding of an

Indian company which is subsidiary of a foreign company arising as a result of amalgamation or demerger of a foreign company subject to the condition that 51% of the shareholders of the amalgamating or demerged foreign company continue to remain the shareholders of the amalgamated or the resulting foreign company.

NOTES:

Unabsorbed business losses can be carried forward and set off against profits from any business from A.Y. 2000-01. There is no need to continue the same business in which the loss was incurred.

Depreciation can be carried forward and set off against the profits from any business in the succeeding assessment year. The business in which the loss was incurred need not be continued in that year.

The effect of depreciation, business loss and investment allowance should be given in the following order:

- Current year's Depreciation
- Unabsorbed Business loss
- Unabsorbed Depreciation
- Unabsorbed Investment Allowance.

A return of loss is required to be furnished for determining the carry forward of such losses, by the due date prescribed for different assesses under section 139(1) of the Act. (S. 80).

Summary:

Set-off in the same year:

(i) Loss relating to the speculative business shall be set-off against the profits from speculative business.

(ii) Long term capital loss can be set-off against long term capital gain only.

(iii) Loss from owing & maintaining of horses can be set-off against the income of that activity.

(iv) Business loss can not be set-off against the income form salary.

(v) Loss from house property can be set-off against any head of income

Carry forward & set-off:

(i) No loss can be carried forward under section 72, 73, 74 & 74A if the return relating to such loss is not filled before due date.

(ii) Loss from house property can be carried forward & set-off against income from house property.

(iii) Business loss can be carried forward & set-off against the income from same business or income from any other business in subsequent year provided speculative loss can be set-off against speculative profit.

(iv) Short term capital loss can be carried forward & set-off against capital gain but long term capital loss can be carried forward & set-off against only long term capital gain.

Loss from the owing & maintaining of race horses can be carried forward & set-off against the income from such activity.

CHANGE IN CONSTITUTION AND SUCCESSION

(1)Where a change has occurred in the constitution of firm the loss attributable to the share of a retired or deceased partner remaining unabsorbed shall not be allowed to be carried forward by the firm. The restriction shall not apply to unabsorbed depreciation.

(2)Where any person carrying on business or profession has been succeeded in such capacity by another person otherwise than by inheritance, then the successor can not have the loss of predecessor carried forward and set off against his income.

Where the business is succeeded by inheritance, the legal heirs (assessable as BOI) are entitled to the benefit of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of predecessor's loss should be made available to the firm CIT Vs. Madhukant M. Mehta, 247 ITR 805 (SC).

Losses in case of closely held company

In the case of company in which public are not substantially interested, the unabsorbed business loss relating to any assessment year can be carried forward and set off against the income in a subsequent assessment year only if the following requirement is fulfilled:

On the last day of the previous year in which the loss is sought to be set off, the shares of the company carrying not less than 51% of voting power are beneficially held by the persons who beneficially held the shares of the company carrying not less than 51% of the voting power on the last day of the previous year in which the loss was incurred.

Exceptions

The above restrictions do not apply to a case if the change in the said voting power takes place due to the following reasons:

i) Death of the shareholder.

ii) Gift by a shareholder to his relative.

The restriction placed under section 79 shall not apply to any change in the shareholding of an Indian Company, which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company. However, 51% of the shareholders of the amalgamating or demerged foreign company should continue to be the shareholders of the amalgamated or the resulting foreign company.

The provisions of Sec. 79 are applicable only in the case of carry forward of losses. As carry forward of unabsorbed depreciation is covered by Sec. 32(2), its carry forward and set off is not affected by sec. 79 [CIT Vs. Shree Subhulaxami Mills Ltd. 249 ITR 795 (SC)].

Loss returns

No loss which has been determined in pursuance of a return filed in accordance with the provision of section 139(3) shall be carried forward under the provisions of section 72, 73, 74 and 74A. this condition does not apply to loss from house property carried forward under section 71B and unabsorbed depreciation carried forward u/s 32(2).

Under section 119(2) (b), the CBDT can condone the delay in cases having claim of carry forward of losses – associated Electro – ceramic Vs. Chairman CBDT, 201 ITR 501 (Kar). CBDT has subsequently issued circular no. 8 of 2001 dated16-05-2001 clarifying and delegating that the commissioners shall have power to condone cases where the claim for loss does not exceed Rs.10000in an assessment year, Chief Commissioners / Director Generals upto Rs. 1 lakh and beyond CBDI shall exercise the power. These norms equally apply for condoning delay in claim for refund.

Relief from Capital Gains Tax

Under certain circumstances, exemption is provided from capital gains tax in case of succession under section 47.

TAX CREDITS

Although Income-Tax is leviable on the previous year in the relevant assessment year, but Income-Tax is being recovered from the assessee in the previous year itself in the following manner:

a) Tax is deducted or collected at sources by the payer at the time of credit or actual payment of certain incomes to the payee.

b) Advanced payment of Income-tax - the assessee in certain cases is under an obligation to payment tax in advance.

c) Self-assessment tax - the assessee has to compute a tax liability in case of his income and remit the tax voluntarily through approved collection centres.

d) In case of employee Tax on non-minatory perquisites paid by employer u/s 192(1A), if any.

The taxes collected under the above systems of recovery of tax in the previous year itself are known as prepaid taxes and tax credits are deductible from the total tax due from the assessee.

In the case of income in respect of which provision is not made for deducting Income-tax at the time of payment and in any case where Income-tax has not been deducted in accordance with the TDS provisions, Income-tax shall be payable by the assessee directly in the form of advance tax or otherwise [section 191].

Where under an agreement or other arrangement, the tax chargeable on any income is to be borne by the person by whom the income is payable, then for the purposes of tax deduction under those provisions, such income shall be increased to such amount as would, after deduction of tax thereon at the rates in force for the financial year for which such income is payable be equal to the net amount payable under such agreement or arrangement [section *195A].*

Every person, being a seller shall, at the time of debiting the amount payable by the buyer to the account of the buyer or at the time of receipt of such amount, whichever is earlier, collect Income-tax from the buyer at specified rates as spelt out in section 206C.

Reliefs in respect of double taxation are spelt out in section 90 and 91 and the same has been discussed in detail elsewhere in the study materials.

Where under any of the provisions of this Act, a refund is due to any person, the Assessing Officer,, in lieu of payment of the refund, set off the amount to be refunded or any part of that amount, against the sum, if any, remaining payable under this Act by the person to whom the refund is due, after giving an intimation in writing to such person of the action proposed to be taken under this section.

TAX INCENTIVES

In respect of all categories of assessees, who derive any profit and gains from a newly established undertaking in Fl'Z and engaged in the export of articles or things or computer software, tax holiday has been provided under sections 10A and 10B of the Act. The profits and gains from the exports of such undertaking shall not be included in the total income' of the assessee in respect of any ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles, things or computer software. No deduction under this Section shall be allowed to any undertaking for the assessment year beginning on the 1st day of April 2010 (extended to '2011'by the Finance Act, 2008) and subsequent years. Where the undertaking initially located in any FTZ or EPZ is subsequently located in a SEZ by reason of conversion of such FTZ or EPZ into a SEZ, the period of exemption, referred to in this paragraph shall be reckoned from the assessment year relevant to the previous year in which the undertaking was first set up in such FTZ or EPZ. The following allowances or expenditure shall be deemed to have been allowed or absorbed during the course of the relevant assessment years:

a) Depreciation allowance [section 32].

b) Expenditure on scientific research [section *35].*

c) Expenditure in relation to family planning [section 36(1)(ix)].

d) Business losses u / s 72(1).

e) Capital gains u / s 74(1) or 74(3).

f) Deduction u/s 8OHH or 8OHHA or 80-I or 80-lA or 80-lB.

The provisions of this relief are entirely at the option of the assessee. 100% of the profits and gains derived from export oriented undertakings can be claimed as a deduction u/s 10B from the export of articles or things or computer software for a period of 10 consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software as the case may be from the total income of the assessee. This exemption is available to all categories of assessees who derive profits andgainsfrom100% EOU.

SEZ

Income of developer and unit in SEZ is exempt for a certain period. This is discussed elsewhere.

Special provisions relating to certain income of non-residents:

Definitions

The provisions contained in this chapter applicable to only individuals can be comprehended in proper perspective only if the following definitions given under the relevant sections are elucidated:

a) The income derived by a non-resident Indian from any foreign exchange asset is called "Investment Income ".

b) "Foreign exchange asset" means the following assets acquired or purchased with or subscribed to in, convertible foreign exchange:

   i) Shares in an Indian company;

   ii) Debentures issued by an Indian public company;

   iii) Deposits with an Indian public company;

   iv) Securities of the Central Government; and

   v) Such other assets as may notified by the Central Government.

c) "Non-resident Indian" means an individual, being a citizen of India or a

person of Indian Origin who is not a resident. A person shall be deemed to be of Indian Origin if he, or either of his parents or any of his grand parents, was born in undivided India.

Note: Since dividend income, except to the extent covered by sec 2(22) (e), is taxable in the distributing company's case and not in the case of shareholders, the provisions of this chapter will not apply in respect of such dividend income with effect from 1-6-1997. This is subject to the change that has been brought about by the Finance Act, 2002.

Deductions in computation:

In computing such "investment income" or "Long term capital gains" of a non-resident Indian, no deduction in respect of any expenditure or allowance under any provisions of the Income-tax Act is allowable. Again no deduction under chapter VIA shall be allowed and indexation will not be applicable.

Tax income 'and" Long term capital gains"

Where the total income of a non-resident Indian consists only of "investment income" and / or income by way of "long term capital gains" arising from the transfer of any foreign exchange asset, such investment income shall be charged to income-tax at a flat rate of 20% and such long term capital gains shall be charged at 10%.

The investment income and / or long-term capital gains in respect of foreign exchange asset will constitute a separate block of income and charged to income-tax at a flat rate of 20% or 10%, as the case may be. If the non-resident Indian has any other income in India, such other income will constitute an altogether separate block of income and charged to tax as if such other income had been the total income. The aggregate of the income-tax so calculated in respect of the said two blocks of income will be the tax payable for the relevant assessment year.

Return of income need to be filed

A non-resident Indian having only investment income or income by way of long term capital gains arising from the transfer of any foreign exchange asset or both, need not file the return of income u/s 139 if the tax deducible from such income has been correctly deducted at source. However, it is permissible for him to opt u/s 115-I of the Income-tax Act to submit the return of income and claim the refund due to him if any.

Benefits after the assessee becomes resident

A non-resident Indian who becomes a resident in any subsequent year has the option to claim that the special provisions shall continue to apply to him in relation to investment income derived from foreign exchange asset [other than shares in Indian companies] for that assessment year and for every subsequent assessment year until the transfer or conversion of such assets into money. Such option can be exercised by furnishing a declaration in writing to that effect along with his return of income for that assessment year.
Note: Since dividend covered by section 115-0 is exempt in the case of the shareholder under section 10(33) it will not be taxable.

Option to assessee:

A non-resident Indian has the option to claim that in respect of any particular assessment year the special provisions relating to taxation of "investment income" and "long term capital gains" under which the tax on such income is to be charged at a flat rate should not apply to him by furnishing his return of income with such declaration for that assessment year u/s 139. In such a case the whole of the total income of that assessment year will be charged to tax under the general provision of the Income-tax Act.

FOREIGN COLLABORATION AGREEMENT AND TAX IMPLICATIONS

Foreign collaboration in India is encouraged by the Government of India on a selective basis. Instead of encouraging mere financial collaborations, collaboration involving import of know-how, which would contribute to the growth of industry and technology in India is generally preferred. Stipulations are made with regard to the following:

1. Initial lumpsum payment to be paid to the foreign collaborator for importing know how or transfer of rights in any technology; Payments for supply of drawings and designs.
2. Royalty and fees for technical services.
3. Payment for supply of machinery and equipment.
4. Payment of interest on monies due.
5. Dividend in respect of shares allotted.

Tax implications in respect of the above are analysed hereunder. Tax planning can be done keeping in view the provisions of Income-tax Act; aspects relating to Double Taxation Avoidance Agreement and the case laws discussed in order to avail exemption or concessional rate or to avoid taxability.

Recently law on transfer pricing has been overhauled and certain stipulations have been made. Compliance with the transfer pricing law is obligatory.

Strategic Management Decisions – Tax Implications

In business, the decisions are taken with a view of optimize returns to the stakeholders. A dominant aspect to be considered taking in view the tax consequences of the same on the bottom-line so as to share minimum profits with Government without violating any tax or any other laws in force.

It is significant that tax consequences alone need not bind the management to take a decision and it is only a factor which influences the management decisions.

Moreover, in case of taxes, there are both direct as well as indirect taxes and in efforts for planning implications of both category of taxes are required to be considered.

Management decisions, which have a bearing on the bottom-line are analyzed below from the point of view of income-tax implications.

1. Make or Buy

Following are the relevant factors for deciding raw materials or components:

(a) Desire for specialization.

(b) Inadequacy of funds to establish new unit for manufacture.

(c) To guard against the risk of technological obsolescence.

(d) To conserve monetary and managerial resources.

(e) Containing risk in case of any new technology.

In making the final decision, the comparison of total cost of manufacture as compared to the buying cost of the product is important.

In computing the costs, care should to be taken so as to include all fixed and variable cost applicable to both the alternatives. In considering the option, possibility of utilizing idle capacity needs to be examined and principles of marginal costing should be applied.

While manufacturing the product or component, it will result in levy of taxes like excise duty, while buying the same will result in payment of taxes in form of VAT, Sales Tax, Octroi. Thus statutory levies such as duty payable, Octroi, VAT, Sale tax, cess etc should be taken into consideration wherever they are applicable in both the alternatives. Aspects of set off of duty or any tax should be considered.

Tax concessions available under the provisions on the Income Tax Act for setting a new unit for making the product will have to be taken in to account. Provisions of different benefits available under various Central, state and local Acts for setting up of a unit will have to be considered.

The costs which are to be compared, in both the cases, should be 'post-tax' calculations.

If purchase price is less than the cost of manufacture, the management should decide to buy the product or component and if it is the other way round, the decision should be in favour to manufacture the product or component.

In case of organizations following transfer pricing for transfer of products from one division to another, this comparison is made to evaluate the efficiency of each division. In case of multinationals, which outsource the manufacture, the design and quality control are kept at the head office while products are manufactured at small scale units. In such cases concessions available to the manufacturing unit should be kept in mind. Other industries for example mineral based industries like steel and cement manufacture, the conservation of mineral wealth have to be kept in mind while taking the decision to make or buy.

2. Own or Lease

The factors which influence the decisions of management relating to owing or leasing of fixed asset are as follows:

(a) Capital outlay – In case of ownership o assets, huge resources are committed on long term basis while case of lease of assets the same is not required. Leasing helps to pay as when we earn. Liquidity and opportunity costs for the amount required which is blocked in acquiring assets weigh a lot in decision making in this regard.

(b) Depreciation - While depreciation can be claimed in the case of assets owned or acquired on hire purchase basis, depreciation is not allowed in case of leased assets. However the entire lease rentals paid are chargeable to Profit and Loss Account.

(c) Repairs and renewal - In both cases, current repairs and renewals can be claimed as deduction. Any expenditure incurred for replacement of certain parts of exiting assets can be claimed as revenue – CIT vs. Mahalakshmi Textile Mills Ltd. 66 ITR 710 (SC).

(d) Hire Charges – Applicable only in the case of lease and fully deductible in computing taxable profits.

(e) Taxes – Lease of assets, if considered as sale and therefore, Sales Tax may be attracted. Aspects of set off of taxes should be considered. Whereas, in case of purchase excise as well as Sales Tax may be attracted. Similarly, aspects of set off of duty or taxes should be considered.

(f) Tax Deducted at Source – In payment of lease charges, care must be taken to comply the TDS prescribed under section 194 I of Income Tax Act.

(g) Technical obsolescence – The risk of obsolescence is avoided when assets are required on lease basis as opposed to ownership basis. If assets, which are bound to become obsolete, are purchased, there may not be any resale value also, for example electronic items such as computers, software.

(h) Scientific Research – In case of expenditure on scientific research, deduction shall be allowed under section 35 on any capital expenditure on plant, machinery, equipments, etc. In certain circumstances even weighted deduction for expenditure on scientific research is available. In such cases buying of an asset may be advantageous.

(i) Closure – In the case of any business which is intended to be carried on only for a particular period of term, it may be more feasible to avail the lease option instead of buying the asset.

(j) Second hand or new – The decision to buy or hire a new or second hand asset depends upon factors like the resources to be committed, condition of the asset and the differential price / rental between the two. In case of a new industrial undertaking, deduction under section 80 IA will not be available if the used plant and machinery account for more than 20% of the total value of the plant and machinery. In some cases where fiscal incentives such as capital subsidy are involved, there is a necessity to restrict the investment up to certain levels only and in such cases trade-offs may have to be exercised and purchases / lease of second hand machinery may be restored to.

(k) Leased assets are not owned assets and therefore the asset cover to equity comes down due to increased dependence on leaser finance.

(l) Financial ratios are also distorted due to greater dependence on lease finance.

(m) Lease rentals generate regular financial commitments whereas owned assets create only one time cash outgo. This would have its own impact on the operating cashflow.

(n) The asset taken on lease is taken back by the lessor at the expiry of the lease period. To find an alternative asset at the expiry of lease period may pose several problems.

3. Retain or Replace

Repair means to restore to good condition, to renovate, to mend by replacing parts or an asset compensating loss or exhaustion. If repairs are carried out a newly acquired asset to install in the business, such expenditure in capital in nature. Repairs should be distinguished from renewal in as much as renewal means reconstruction of the premises entirely or substantially [CIT vs. Sri Rama Sugar Mills Ltd 21 ITR]

In cases where the assets are maintained in excellent conditions due to the maintenance policies pursued by the company or the sturdiness of the asset, it would be economical to retain the asset as the replacement cost may be uneconomical. This is true in cases where the inflation replacement cost of the concerned machinery building industry is very high.

Further in developing and underdeveloped countries such as ours, due to technology policy pursued, there is a possibility that we might have purchased machinery which have been removed from the manufacturer's current list and in such cases, we are left with no other alternative except to retain the current asset. The replacement in such situations would be prohibitive in terms of costs.

Repairs can result in outflow of cash in form of payment of service tax. Renewals, result in payment of indirect taxes like excise duty, sales tax. In either case, there may be a possibility of set off of such taxes that also needs to be examined.

While in retaining the asset, the full amount of repairs will be allowed as deduction as business expenditure while in case of replacing the asset, depreciation as per prescribed limit will be allowed as deduction.

'Repair' implies the existence of a thing which has malfunctioned and can be set right by effecting repairs which may involve replacement of some parts, thereby making the thing as efficient as it was before or as close to it as possible. Replacement is different from repair. Replacement implies the removal or discarding of the thing that was in use, by a different or new thing capable of performing the same function with the same, lesser or greater efficiency. The replacement of a section in a series of machines which are interconnected in a segment of the production process which together form an integrated whole may, in some circumstances, be regarded as amounting to repair when without such replacement that unit in that segment will not function. The logic cannot be extended to the entire manufacturing facility from the stage of raw material to the delivery of the final finished product - CIT v. Madras Cements Ltd. 255 ITR 243(Mad.).

Total replacement of four cement mills into one cement mill will not constitute 'repair' - Where the assessee replaced the existing four cement mills by a new cement mill at a different location, and the new mill was technologically superior and was far more efficient that the earlier four mills together, and was also capable of delivering a recognizably superior product, the expenditure on such replacement cannot be treated as 'repair' under section 31 - CIT v. Madras Cements Ltd. 255 ITR (Mad.).

Total replacement of damaged equipment is not 'repair' - Where the assessee replaced the electric control panel which was damaged and was beyond repair, by a new control panel, the expenditure on such replacement cannot be treated as 'repair' under section 31. It would be a case of capital investment and would not be a case of repair - Deputy CIT v. S.T.N. Textiles Ltd. 257 ITR (Ker.).

4. Repair/Scrap or Return

The term 'current repairs' means expenditure on buildings, machinery, plant or furniture which is not for the purpose of renewal or restoration but for preserving an already existing asset. Current repairs indicate repairs which are attended to when the need for them arises from the businessman's view and these are not allowed to be in arrears or to be accumulated. Current repairs are allowed as business expenditure in the computation of income.

Sale of scraped assets will attract VAT, Sales Tax and care should be taken to collect the same.

Sometimes it would be economical feasible to scrap the asset than to spend money in repairing it. However in such cases, the implications of section 50 have to be kept in mind as money realized on scraped asset sales will have to be reduced from WDV of the block of assets.

In cases where the machineries are obtained under a warranty, the machinery is returned to the manufacturer in case there is substandard performance. In case any repairs are carried out, the same expenditure has to be received from the manufacturer and cannot be treated as business expenditure.

5. Export or Domestic Sale

Indian companies are eligible to claim deductions of profits earned from the business of export of goods or services subject to fulfilment of certain conditions. However, these are available only for 10A [Free Trade Zones], 10AA [Special Economic Zone], 10B [Export-oriented undertakings]

The term 'profits of the business' referred in the above section is different from the term 'profit of business' referred to under the head 'profits and gains of business or profession'. The export turnover means sale proceeds received in, or brought into, India by the assessee in convertible foreign exchange, within a period of six months from the end of the previous year or within such further period where such sale proceeds are credited to a separate account maintained for the purpose by the assessee with any bank outside India with the approval of the Reserve Bank of India. It does not include freight or insurance attributable to the transportation of the goods beyond the customs station of India. The profits of the export business would be computed after claiming the deductions available as under:

Tax concession available in respect of profits and gains from projects outside India (80HHB), export profits (80HHC), services provided to foreign tourists (80HHD), export of computer software (80HHE), export or transfer of film software (80HHF) have been withdrawn from 1st April, 2005.

Moreover in case of exports risk of forex loss also exists or there may be gain in realization at times.

6. Shut Down or Continue

The income chargeable as 'profits of the business only' if the assessee carries on the business at anytime during the previous year. It is however not necessary that the business is carried on throughout the previous year or till the end of the previous year – [CIT Vs Bangalore Transport Company (1967) 66 ITR 573 (SC)].

When the assessee does not carry on the business, it therefore implies, section 28 cannot be applied and the amount that he receives cannot bear the character of profits of the business. In case of temporary suspension of business to overcome business crisis without any intention of the assessee to part with the business, it would be better to lease out the business assets and earn revenue so that the income earned is assessable as income from business and not otherwise – [CIT Vs Vikram Cotton Mills Ltd. (1988) 169 ITR 597 (SC)]. In the following cases, even though no business has been carried on by the assessee, the receipts are taxable as income from business in the year of receipt:

a) Recovery against any loss, expenditure or trading liability earlier allowed as a deduction [section 41(1)]

b) Balancing charge in the case of electricity companies [section 41(2)]

c) Sale of capital asset used for scientific research [section 41(3)]

d) Recovery against bad debts [section 4 1(4)].

e) Amount withdrawn from special reserve [Section 41 (4A)]

f) Receipt of discontinued business under cash system of accounting [S. I 76(3A),(4)].

g) Sec 50

The cessation of business may occur in two ways:

a) Where the business is no longer in existence.

b) Where the business is in existence but has been transferred by the assessee as a going concern to another entity,

The succession and discontinuance are mutually exclusive concepts as there cannot be discontinuance where there is succession. Further if a part of the business of an assessee is dropped owing to non-profitable nature either permanently or temporarily, it will not imply that the

business has been discontinued. In the case of dissolution of a firm or a liquidation of a company, sometimes the trade may be carried on even after such dissolution or liquidation. There could be other examples of discontinuance of business as under:

a) Amalgamation of two separate and independent businesses belonging to distinct owners resulting in discontinuance of those businesses.

b) Partition of a joint family business and the business is divided amongst the members. In this case there would be discontinuance of the old business even if some or all the members carry on their own business in the same premises and take the advantage of the old business connections.

c) In case a firm is split tip into two different firms and the old business is also divided amongst the different firms, the original firm shall be deemed to have discontinued the business.

d) If a professional leaves his practice, there would be discontinuance. The question whether the professional discontinued his profession or not depends on the state of his mind at the time of cessor merely because he takes to the profession once again, it cannot be said that there is no discontinuance at the time of cessor.

e) Spin-off - The common definition of 'spin off' is when a division of a company or organization becomes an independent business. Spin off is feasible when loss making or profit making unit is separated from the main unit. For example if a manufacturing unit is going in losses, while the land property it holds, if separated from the main unit may fetch profits on sale of the same.

In all the above cases, the mischief of section 176 regarding accelerated assessment would come into play.

Profits arising out of sale of fixed assets shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

Sometimes due to change of economic circumstances, the manufacture of a product would become costlier than buying it from the open market. In case this situation continues for a long time, the assessee may have to sell the existing plant and machinery and seek an exit. In this case, there will be short-term capital gain or loss if the entire block of assets is sold or there will be a short-term capital gain if the part of the block is sold for a price more than the written down value of the block.

7. Expand or Contract

The profits and gains of any business follow the business cycle and depending upon the phase in which the particular company is positioned in the industry; there could be either an expansion or contraction of business. Depending upon the macro-economic scenario, an industry may either face an upbeat situation of rising demand for its products not only in the markets in which it is operating but also in newer markets. In case the trend is a continuing one, the

owners may decide to expand the manufacturing facilities or set up manufacturing facility in newer markets. In the case of the latter, the owners may also form joint ventures with local partners. The mergers and acquisitions route may also be followed to meet the sudden upsurge in demand or to gain monopolistic status. In some other cases, outsourcing through contract manufacture may also be resorted to.

In case of recession in the industry, there will be slack in the demand for the product and the management may either take any of following alternatives:

a) Pull out of a market by closing down the local unit.

b) Cut down the production by reducing the number of shifts or number of working days.

c) Discontinue the business, where there is no hope of revival of product demand

The tax implications of the above managerial alternatives are:

a) To claim tax relief in respect of profits from new undertakings.

b) To claim depreciation on new investments.

c) To claim depreciation on R&D activities.

d) To claim deduction in respect of additional manpower employed.

e) To claim necessary relief for export of products, goods or services.

f) To claim necessary relief in respect of location of the industry.

g) To prepare for accelerated assessment u/s 176 in the eventuality of closing down of the unit.

8. Mergers And Acquisitions

Merger is a combination of two or more companies into one company and it may involve either absorption or consolidation. A merger, in which one of the companies loses its identity and assets and liabilities of the company are taken over by the acquiring company is termed as absorption, e.g. TOMCO with HLL, Reliance Petrochemicals with Reliance Industries, Renusagar Power Supply with Hindalco Industries Ltd. A merger, in which all the participating companies go out of existence to form a new company, is referred to as amalgamations, e.g. Tetra Pack and Alfa Laval into TetraLaval, Forbes Campbell with Gokak Patel Volkart to form Forbes Gokak, Oriental Carpets, Digvijay Woolen Mills and Universal Electric to form VXL India Ltd, Mudra Communications, Interact Communication and Vision Advertising to form Interact Vision.

Acquisition / takeover involve the transfer of controlling interests in a company from one management group to another. Typically it involves the bidding company making a tender offer directly to the shareholders of the target company. The tender offer is an offer to purchase the share of the target company at a fixed price per share from shareholders who tender their shares. To induce the shareholder of the target company to sell the shares, the tender price is

usually set significantly above the current market price. Use of tender offer allows the acquiring company to bypass the management of the target company it wishes to acquire. The term 'takeover' is also used to refer to this project e.g. acquisition of controlling interest in –

a) Chloride India by the S K Birla Group,

b) Harrison Malayalam Plantation by the R P Goenka Group,

c) Rallis India by Tata Tea,

d) Consolidated Coffee by Tata Tea, etc.

In merger transactions, the consideration is paid for and received in shares and both the merging partners receive money in future in the form of dividends. No money transaction is usually implied at the time of entering into a merger agreement. Whether the share capital is pooled or assets are pooled, so long as a share for share exchange takes place between the contracted parties, the transaction is a merger. In an acquisition, the consideration is in the form of cash. The person or the corporation intending to control another corporation buys the controlling interest in the share capital through open market operations. The seller if the shares receives money in the current period of the transaction and the buyer of the share settles the same based on market prices.

Under section 394 of the Companies Act, amalgamation includes absorption and the amalgamation under the company law may be by order of the court or by the Central Government, if it is in public interest. The memorandum of association of both the companies must provide for amalgamation and under section 391 and 394 of the Companies Act, 1956 the Central Government's approval of the merger proposal is necessary for filing petition before the FERA, 1973 (Section 6 of FEMA, 19999) for transfer of share involving NRIs or foreign nationals.

The Income-Tax Act has defined 'amalgamation' under section 2(1B).

'Amalgamation', in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that -

a) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation.

b) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation.

c) shareholders holding not less than three-fourths in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the

amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation,

If the amalgamated company wishes to set off the losses and unabsorbed depreciation of the amalgamating company with its profits, the conditions mentioned in section 72 A should be fulfilled.

Thus under section 72A where there has been an amalgamation then, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly

For example where the property of company A, which merges is sold to the other company B and the amalgamation comes about by virtue of transaction of sale. This is to exclude from amalgamation the cases where the scheme of amalgamation is not approved by the High Court. Where the company A, which merges is wound up in liquidation and the liquidator distributes the property of company A to the company B and the amalgamated company B receives the property of company A from the liquidator, there is no amalgamation. Sometimes it would be advantageous to look at reverse merger option.

Under section 47 (vi)(a) any transfer, in a scheme of amalgamation, of a capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company, if –

a) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company, and

b) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated.

9. Demerger

As per section 2(19AA) 'Demerger', in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, by a demerged company of its one or more undertakings to any resulting company in such a manner that -

a) All the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger.

b) All the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger.

c) The property and the liabilities of the undertaking or undertakings being transferred by

the demerged company are transferred at values appearing in its books of account immediately before the demerger.

d) The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis.

e) The shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger.

f) Otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company.

g) The transfer of the undertaking is on a going concern basis.

h) The demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

With a view to recognize the demerger slump sale and to rationalize the provisions of amalgamation a number of amendments have been made in the Income Tax Act should be considered. The effect of these provisions is that demerger would now be taxed neutral and would not attract any additional liability to tax. Further, in demerger, the tax benefit and the concession available to any undertaking would be available to the said undertaking on its transfer to the resulting company.

Under section 47(vi)(c) any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if -

a) the shareholders holding not less than three-fourths in value of the shares] of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated

Under section 72 A in the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall

a) where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company.

b) where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company

and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

The above provisions should be borne in mind in case of demergers

10. New Capital Investments

In the case of any fresh investments in business arising out of expansion or diversification or takeover of a business, the tax consequences of such managerial decisions are weighed. In such cases the assessee is entitled to:

a) Claim normal depreciation allowances.

b) Claim additional depreciation allowances.

c) Tax incentives in respect of export turnover.

d) Incentives for employing additional manpower.

e) Carry forward of unabsorbed depreciation and business losses.

f) Tax holiday on the profits and gains of the new undertaking.

11. Accounting Standards for Taxes on Income

The Institute of Chartered Accountants of India has issued Accounting Standards in respect of accounting periods commencing on or after 01-04-2001. This Accounting Standard will be mandatory in nature. It is known as Accounting Standard (AS 22) on 'Accounting for Taxes on Income'. The various matters covered in this Accounting Standards relate to the following, inter alia, matters:

a) Accounting for Taxes on Income.

b) Definitions of Accounting profit (loss), taxable profit (tax loss), Tax expense provision for taxes payable, Timing differences, Permanent differences, etc.

c) Effect of permanent and Timing Differences on Taxable profit and Accounting profit.

d) Taxes Payable Method.

e) Tax Effect Accounting Method, and its application.

f) Consideration of prudence.

g) Calculation of Deferred Tax Adjustments.

h) Amalgamation

i) Transitional Provisions

j) Disclosure

k) Examples of Timing Differences

l) Illustration regarding Taxes payable and Tax Effect Accounting Methods.

m) Illustration regarding Application of Tax Effect Accounting Method in case of Loss.

n) Full Provision Method.

o) Liability Method.

12. Tax audit of certain persons carrying on business or profession

It is provided in Section 44AB that in the following cases tax audit will be compulsory:

a) Where the total sales, turnover or gross receipts, as the case may be in business exceed or exceeds Rs.40 lakh in any previous year; or

b) Where the gross receipt in profession exceed Rs. 10 lakh in any previous year; or

c) Where a person carrying on the business, if the profits and gains from the business are deemed to be the profits and gains of such person u/s. 44AD / 44AE / 44AF as the case may be and has claimed his income to be lower than the profits or gains so deemed in any previous year.

Different forms to be prescribed by Rule 6G for Tax Audit Reports, which are as under:

a) Form 3CA: Tax audit report in the case of a person who carries on business and who is required to get his accounts audited under any other law.

b) Form 3CB: Tax audit report in the case of a person who carries on business and who is not required to get his accounts audited under any other law.

c) Form 3CC: Tax audit report in the case of professionals.

d) Form 3CD: Prescribed particulars in the case of (i) and (ii) above.

e) Form 3CE: Prescribed particulars in the case of (iii) above.

The last date for furnishing of Tax Audit Report is 30th September of the Assessment year concerned for companies.

Modification of provisions regarding compulsory audit of accounts — Section 44AB:

The Finance Act, 2001 has, with effect from the assessment year 200 1-02, amended Section 44AB to provide that in the case where the amounts are required to be audited by or under any other law, it would be sufficient compliance with the provisions of the said section if the person gets the accounts audited under such law before the specified date and furnishes by that date,

the report of the audit under such other law, and a further report from a Chartered Accountant in the prescribed form under Section 44AB.

13. Accounting for International Transactions

Under section 92D following provisions should be followed in maintenance and keeping of information and document by persons entering into an international transaction.

a) Every person who has entered into an international transaction shall keep and maintain such information and document in respect thereof, as may be prescribed.

b) Without prejudice to the provisions contained in sub-section (1), the Board may prescribe the period for which the information and document shall be kept and maintained under that sub-section.

The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceeding under this Act, require any person who has entered into an international transaction to furnish any information or document in respect thereof, as may be prescribed under sub-section (1), within a period of thirty days from the date of receipt of a notice issued in this regard.

Noncompliance attracts penalty.

14. Allowances vs. Perquisites

As per section 17 allowances and perquisites are part of salaries and are taxable in the hands of employee.

However, certain perquisites are taxable in the hands employer in the form of Fringe Benefit Tax.

Therefore, the employer should figure out what is beneficial for the company but not at the cost of additional burden to the employees and should find a suitable policy for payment of salary.

15. Preference Capital vs. Debentures

Preference capital represents a hybrid form of financing. It partakes of some characteristics of equity and some attributes of debentures. It resembles equity in the way that preference divided is payable only out of distributable profits.

Payment of dividend to preference shareholders results in payment of Dividend Distribution Tax by the Company, but receipt of tax-free income by the shareholders.

Debentures are instruments for raising long-term debt capital. Debenture holders are the creditors of the company. The obligation of the company towards its debenture holders is similar to that of a borrower who promises to pay interest and capital at specified times. The specific cost of debt capital, represented by debentures, is much lower than the cost of preference or equity capital. This is because the interest on debentures is allowed as deduction, and the effective cost of debentures is much less.

Payment of interest does not call for any additional liability on the Company, and receipt of taxable income by the debenture holders. Interest also attracts TDS.

Evolving Capital Structure

Before setting up a new project, decision regarding the capital structure has to be taken. While opting for a particular capital structure, the following consideration are borne in mind:-

a) Servicing the capital base with consistent dividend / yield policy,

b) Cost of capital to be raised from the market.

c) Chargeability or otherwise of taxes i.e. direct and indirect taxes.

d) Policy on plough back of profits for future plan towards diversification, expansion modernization and other development aspects.

e) Cost of servicing the capital e.g. for bank finance monthly / quarterly statements are required to be furnished, in case of public issue quarterly accounts are requird to be published, etc; for which costs are required to be incurred.

Generally the means of finance selected under India conditions for a new project comprises of:-

1) Equity share capital.

2) Preference share capital

3) Borrowings from financial institutions / bank-Loans.

4) External Commercial Borrowing.

5) Borrowings from the capital markets through debentures and debt instruments.

6) Lease financing.

In making capital structure decision, the financial leverage plays an important role. The percentage increase in Earnings Before Tax (EBT) in relationship to percentage increase in Earnings Before Interest and Taxes (EBIT) expressed as a percentage is the financial leverage of the structure opted. This can be explained in the form of an example.

EBIT	1000
Less: Interest on securities	500
EBT	500

Financial Leverage1000 / 500=2

This would mean that any increase in EBIT would have two fold increase in EBT. So if EBIT were 1500, EBT would be 1000. Therefore it is clear that 50% increase in EBIT has resulted into 100% increase in EBT.

As a corollary to the above, a high financial leverage would result in a very high return when there is high profitability. But in case of depression, this would be counter productive as the residual net income available to shareholders may be considerably reduced and may sometimes end up in loss. The fluctuations in operating profits and debt-equity mix would indicate the safety parameters and get reflected in the financial leverage.

A capital structure is said to be optimum when it has a mixed bag of debt and equity stocks and it has the lowest weighted average cost of capital. The advantage of having an optimum capital structure is to maximise the value of assets of the company and the wealth of its owners and minimizes the cost of capital, which in turn, raises its ability to have inbuilt additional investment opportunities. At the same time a high debt equity ratio is also not prudent. A high debt equity ratio has its own advantages and disadvantages. Problem of planning capital structure is of crucial importance and has long term implications. The tax planner should properly balance risks, costs, control and tax considerations. In capital structure decisions, the cost of capital is an important consideration along with the risk factor. One of the main reasons for raising finance through borrowings (in preference over equity shares) is to increase earnings on equity share capital. But excessive use of debt capital, increase the risk of the company as is witnessed in the country.

While the interest paid on debt instruments is tax deductible [section 36(1)(iii)], the dividend paid would be construed as apportionment of profits. The interest received by the shareholder is taxable in the hands of the recipient and any ROI calculations would be on net of tax basis. The cost of raising finance through debts is deductible in the year in which it is incurred (except where it is incurred during the pre-commencement period in which case, it has to be capitalised). The cost of issue of shares is allowed as a deduction in 10 years under section 35D of Income Tax Act. Because of aforesaid provisions, corporate taxation plays an important role in determining the choice between different sources of financing.

Moreover, in case pf capital – equity or preference – the Company is liable to pay dividend distribution tax and on the other hand shareholders receive tax free dividend.

In case of ECB, possibility of forex - loss or gain – needs to be taken into account.

AMORTIZATIONS

Any Indian company or a person other than a company, who is resident in India, can claim deduction u/s 35D read with rule 6AB of any expenditure incurred on the following:

1) Expenditure incurred before the commencement of business i.e. setting up of a new industrial unit.

2) Expenditure incurred in connection with existing industrial undertaking i.e. business expansion.

The expenses that qualify for deduction are:

1) Preparation of a feasibility report.

2) Preparation of a project report.

3) Conducting market survey or any other survey necessary for the business of the assessee.

4) Engineering services relating to the business of the assessee.

5) Legal charges for:

   i) Drafting any agreement between the assessee between the assessee and any other person relating to the setting up or conduct of business of the assessee.

   ii) Drafting Memorandum and articles of Association.

6) Printing of Memorandum and Articles of association.

7) Fees for registering the company under the provisions of the Companies Act, 1956.

8) In connection with the issue for public subscription of shares or debentures of the company such as underwriting commission, brokerage, charges for drafting, typing, printing of prospectus and advertisement.

9) Any other expenditure not allowable under the provisions of the Act.

The expenditure on items (a) to (d) can be incurred either by the client or by engaging an approved consultant.

The aggregate of the expenditure shall not exceed 5% of the cost of the project or capital employed in the business whichever is beneficial to the company. The amounts qualifying as per the limits specified above shall be allowed as a deduction in five equal instalments beginning with the previous year of the commencement of the business or the period in which the extension of the industrial undertaking is completed and the new unit commences production or operations.

In the case of amalgamation / de-merger, the provision of this section shall as far as may be applied to the amalgamated company as they would have applied to the amalgamated company as if the amalgamation had not taken place.

Where an assessee, being an Indian company, incurs any expenditure wholly or exclusively for the purpose of amalgamation or de-merger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one fifth of such expenditure for each of 5 successive previous years beginning with the previous year in which the amalgamation or de-merger takes place (section 35DD). No deduction shall be allowed in respect of the expenditure under other provisions of the Act.

If the expenditure on amalgamation were incurred by the amalgamating company, it would be able to claim one-fifth expenditure in the year of amalgamation but the balance four-fifth ex-

penditure will not be allowed as deduction to the amalgamating company as it ceased to exist. On the other hand if such expenditure were incurred by the amalgamated company, it would be eligible to deduction over a period of five years as it continues to exist. However, in the case of de-merger, both the companies continue to exist hence the problem does not arise.

Where an assessee incurs any expenditure in any previous year by way of payment of any sum to an employee at time of his voluntary retirement, in accordance with any schemes of voluntary retirement, one fifth of the amounts so paid shall be deducted in computing profits and gains of the business for that previous year and the balance shall be deducted in equal instalments for each of the four immediately succeeding previous years. No deduction shall be allowed in respect of such expenditure under any other provisions of the Act. The deduction is allowed u/s 35 DDA so as to provide that where the undertaking is transferred before the expiry of the period specified to another Indian company in a scheme of amalgamation or de-merger, the deduction shall continue to be available to the amalgamated or the resulting company, as if the amalgamation or de-merger had not taken place. In case of recognition of certain forms of business whereby a firm or a proprietary concern is succeeded by a company, the deduction shall be available to the successor company. Further in the year of transfer, no deduction shall be available to the amalgamated company, demerged company, the firm or proprietary concern as the case may be.

SHORT TERM BORROWINGS

It is normal for any business to borrow money for the purpose of business and in the case of companies; the borrowings can be in the form of loans and public deposits in the short to medium term and term loans in the medium to long term. The amount of interest paid in respect of capital borrowed for the purpose of business or profession is allowed as deduction [Section 36(1) (iii)]. The basic requirements are:-

The money must have been borrowed by the assessee.

It must have been borrowed for the purposes of business, profession, or vocation.

The interest must have been paid and claimed as an allowance. In case accrual method is followed, the amount of interest due would also be allowed.

However, any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession, whether capitalised in the books of account or not; for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction. It can be included in cost of the asset.

Few important principles in respect of allowability of interest expenditure are as under:

Even where the assessee has surplus funds, it was held that the Department has no right to question the need of the borrowings- CIT Vs Bombay Samachar Ltd. (1969) 74 ITR 723 (Bom).

In the case of genuine borrowing, the Assessing Officer cannot object to the interest rates-CIT Vs Tarai Development Corporation Ltd. (1994) 205 ITR 421 (All).

Interest is allowable irrespective of the facts whether the borrowings is utilised for working capital or for acquisition of a capital asset- CIT Vs India Cements Ltd. (1966) 60 ITR 52 (SC).

It is not necessary that the investments made out of borrowed funds should yield any profit in the year – Calico Dyeing & Printing Works Vs CIT (1958) 34 ITR 265 (Bom).

The claim for interest paid by a firm to its partner cannot exceed 12% per annum.

Interest on money borrowed prior to commencement of business has to be capitalized.

Interest on money borrowed for meeting personal obligations of the assessee or its partners or directors will not be allowed.

Interest on money borrowed for meeting any income - tax liability is not allowed.

Interest paid on purchase of debentures will not be allowable u/s 36(1)(iii), but may be allowed u/s 37(1).

Assessee carrying on jewellery business commencing exhibition of cinematographic films. Capital borrowed for constructing cinema theatre, which was run for several years and then transferred. Loan has been obtained for business purposes. Business of jewellery and that of exhibition of films being composite one, interest on capital borrowed held deductible for periods after cinema business discontinued – Veecumsees Vs CIT (1996) 220 ITR 185 (SC).

Where the money is borrowed or used for the purposes of putting up a building in which the assessee had not interest and through diversion of funds, the interest is not deductible – CIT Vs Indian Express Newspapers (Madurai) Pvt. Ltd. (1999) 104 Taxman 578 (Mad).

Interest on money borrowed for expansion of the old business is allowable as a deduction whether the expanded unit has gone into production or not – CIT Vs Bhilai Iron Foundry Ltd. (1998) 234 ITR 661 (MP).

Where the borrowed money has been initially invested in business and subsequent diversion of funds take place, such diversion must be clearly established and not matter of mere speculation. If the amount diverted were subsequently brought back into business and utilised into business, the interest is allowable but not so long as the diversion continues – K Somasundaram & Bros. Vs CIT (1999) 153 CTR 153 (Mad).

The onus is on the assessee to prove that the interest is deductible – CIT Vs Mir Mohd. Ali (1964) 53 ITR 165 (SC). Where however if the Assessing Officer disallows part of interest on account of diversion of funds, the onus shall be on the Assessing Officer to prove such diversion – Modipon Ltd. Vs ITO (1985) 22 TTJ 108 (Del).

Interest on money borrowed for payment of dividends is an allowable deduction.

Interest paid outside India is not allowable as deduction unless tax has been paid / deducted at source.

Interest under the residuary provisions of sections 37(1) has to be explode where the interest is deductible u/s 36(1)(iii). However only one deduction will be allowed.

PROFIT DISTRIBUTION

While interest is paid as the yield on investments to the lenders, the return on investment to the equity / preference shareholders takes the form of dividends or bonus shares or rights issue.

Company is required to pay dividend distribution tax on dividends paid to shareholders, who get it tax free. This is discussed elsewhere.

The word 'dividend' in its ordinary connotation means the sum paid to or received by a shareholder proportionate to his shareholding in a company out of the total sum distributed. Section 2(22) of the Income-tax Act has given an inclusive definition.

Dividend from a foreign company including deemed dividend shall be taxed under the head 'income from other sources.'

Any distribution by a company to the extent of accumulated profits whether capitalized or not, if such a distribution entails the release of all or any part of the assets of the company to its shareholders shall be declared as dividend under the Act [section 2(22)(a)]. The main ingredients of taxation of dividend are —

(a) the company should possess accumulated profits and

(b) such accumulated profits are distributed in cash or in kind.

Where the distribution is in kind, the market value of the asset (not the book value) shall be deemed dividend in the hands of the shareholders. The provisions of section 2(22) (a) are not attracted in case where a company merges into another company in a scheme of amalgamation.

Any distribution to its shareholders (equity or preference) by a company of debentures, debenture stock or deposit certificates in any form whether with or without interest to the extent of accumulated profits whether capitalized or not shall also be deemed as dividend. Similarly any distribution to its preference shareholders of shares by way of bonus to the extent to which the company possesses accumulated profits whether capitalized or not shall be deemed as dividend. However mere capitalization of accumulated profits by issue of bonus shares to equity shareholders does not entail the release of the assets of the company and hence shall not be deemed to be dividend.

Any distribution made to the shareholders of a company on its liquidation to the extent to which such distribution is attributable to the accumulated profits immediately before its liquidation whether capitalized or not shall be deemed as dividend. However the shares issued for full consideration, where the holder of the shares is not entitled to participation in the surplus assets in the event of liquidation, is not a deemed dividend. The provisions of section 2(22) (c) are not attracted in case where a company merges into another company in a scheme of amalgamation.

Any distribution to its shareholders by a company on the reduction of its capital to the extent to which the company possesses accumulated profits, whether such accumulated profits have

been capitalized or not, shall be deemed as dividend. For this purpose, profits of the company up to the date of the resolution permitting the reduction of capital shall form part of the accumulated profits. The deemed dividend does not include any distribution to shareholders on liquidation or reduction of capital of the company in respect of any shares issued for full cash consideration where the holder of the shares is not entitled in the event of liquidation to participate in the surplus assets i.e. preference shareholders.

Any payment by a company (other than a company in which the public are substantially interested) of any sum (whether as representing a part of the assets of the company or otherwise) by way of advance or loan to the extent of accumulated profits (excluding capitalized profits) to an equity shareholder who is the beneficial owner of shares holding not less than 10% of the voting power or to any concern iii which such shareholder holding not less than 10% of the voting power is a member r a partner and in which he has a substantial interest or any person on behalf of or for the individual benefit of any such shareholder. Even if such loans are advanced against interest, the section 2(22)(e) is applicable. The deemed dividend shall not be exempt u/s 10(33), though the closely held company who made the advance or loan was a domestic company.

The concept of dividends will not cover the following transactions:

1. Any advance or loan to a shareholder or a specified concern by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company.

2. Any dividend paid by the company, which is set off bi the company against the whole or any part of the loan or advance paid by it previously and which has been treated as deemed dividend u/s 2(22)(e). In this case, the dividend so set off shall not be treated as dividend in the hands of the shareholder [section 115-0].

3. Any distribution made in accordance with clause (c) or (d) of section 2(22) in respect of any share issued for full consideration to preference shareholders.

4. Any payment made by a company on purchase of its own shares from a shareholder pursuant to section 77A of the Companies Act, 1956.

5. Any distribution of shares pursuant to a de-merger by the resulting company to the shareholder of the demerged company (whether or not there is a reduction in capital of the demerged company).

The following principles are generally applied in the case of treatment of such transactions [section2(22)(e)]:

1. One should be a shareholder on the date the loan was advanced.

2. If the payment is made by a closely held company to a substantial shareholder by way of advance or loan, etc, it cannot be deemed as dividend u/s 2(22)(e) even if the company were in possession of accumulated profits, which had already been capitalized prior to such payment - Badiani P. K. Vs CIT (1976) 105 ITR 642 (SC).

3. If the accumulated profits possessed by the company at the time of payment exceed the amount of payment made by the company, the whole of the payment should be regarded as payment and not only that part of it, which represented proportionate share of the shareholder in the accumulated profits of the company. However the amount of payment so made is larger than the accumulated profits possessed by the company, only that part of the payment, which is equal to the amount of accumulated profits would be deemed to be dividend [CIT Vs Mayur Madhukant Mehta (1972) 85 ITR 230 (Guj)J.

4. The amount of the loan, etc granted to a mere beneficial owner of the shares, who is not a registered shareholder, cannot be deemed as dividend - Rameshwarlal Sanwarmal Vs CIT (1980) 122 ITR I (SC).

5. An advance or loan made to the corporate entity say to a holding company by its subsidiary can attract the provisions of section 2(22)(e) on fulfillment of all the conditions laid down in that behalf- Sadhana Textile Mills Pvt. Ltd. Vs CIT (1991) 188 ITR 318 (Bom).

6. Sale of goods on credit does not amount to a transaction of loan although a debt is created - Lakhmichand Muchhal Vs CIT (1961)43 1TR 315 (MP).

7. Temporary advances or loans do not fall within the mischief of section 2(22)(e). The fact that the loan or advance was factually repaid or made good within a short period is no defence to the attraction of the provision - Waichand & Co. Ltd. Vs CIT (1975) 100 ITR 598 (Born).

8. The word 'advance' means something which is due to a person but paid to him ahead of the time - CIT Vs Srinivasan K (1963) 50 ITR 788 (Mad).

9. Whenever a loan or advance is routed through an employee to the Managing Director, who needs the money, such loans made by the company to the employee fell in the category of benefit to the assessee and were therefore were assessable as deemed dividends in his hands even though he is not a party to the transaction directly - CIT Vs Alagusundaram Chettiar L (1977) 109 ITR 508 (Mad).

10. Payment of shareholder's personal expenses, insurance premia, etc would also be covered within the ambit of section 2(22) (e) to the extent of the accumulated profits of the company - CIT Vs Srinivasan K (1963) 50 ITR 178 (Mad).

11. Accumulated profits mean commercial profits and not assessable income - Badiani P. K. Vs CIT (1976) 105 ITR 642 (SC).

12. Even if the accumulated profits in the hands of the company are derived from agriculture and agricultural income is exempt from tax, the money received by the shareholder is taxable as the character of receipt changes - Kumaraswarni S Vs ITO (1961) 43 ITR 423 (Mad).

13. The accumulated profits include all profits of the company up to the date of distribution of the payment and include all profits of the company till the date of liquidation subject to the exception provided in section 2(22)(c).

14. Accumulated profits include general reserve - CIT Vs Srinivasan K (1963) 50 ITR 178 (Mad).

15. The accumulated profits get reduced by the amount already deemed to be dividend u/s 2(22)(e) even if no adjustments is made in the books of accounts - CIT Vs G Narasimhan (1999) 102 Taxmann 66 (SC).

For payment of dividend distribution tax, dividend under section 2(22)(e) is not covered. Similarly it is not exempt in the hands of a shareholder.

The following expenses can be claimed as deduction from gross dividend income, if such dividend is taxable in the hands of the assessee:

1. **Collection charges** — Any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realizing the dividend.

2. **Interest on loan** — Interest on money borrowed for purchasing the shares can be claimed as deduction even where no income is earned on such shares.
3. Any other expenditure not being an expenditure of capital nature expended wholly and exclusively for the purpose of making or earning such income can be claimed as a deduction.

In case of equity bonus shares, the tax treatment and the implication for the investor are not difficult to understand. In the case of bonus shares, the bonus shares would be assumed to have been acquired at 'zero cost' and the entire sale consideration on disposal of shares will be subject to capital gains. The investors have no tax effect in the bonus shares are received and the incidence of tax would arise only at the point of sale. The main question thus confronting the investors would be whether the gain should be short-term or long-term in nature. If the shares are sold after a period of 12 months, it will be considered as being long-term in nature, which is beneficial from tax angle for those who fall in the higher tax bracket on account of lower rate of tax. In the case of bonus debentures, the investor receives a debenture free of cost based on equity holdings in the company. This receipt is termed as a deemed dividend under the tax laws and taxable in the hands of the receiver. Thus there will be an element of income and tax when the bonus debentures are issued. The point to note is that when the debentures are redeemed at face value, on its maturity, there will not be any gain or loss for the investor. In addition the interest that will arise on the debenture will be taxable in the hands of the investor as income from other sources. E.g. HLL Bonus debenture issue. Instead of debentures, if the company chooses to issue bonus redeemable preference shares there is also a return of the principal amount after a certain number of years. These shares would not qualify as normal dividend or as deemed dividend in terms of the Income-tax Act, 1961 and therefore would mean no tax effect at the time of the issue of bonus. The incidence of taxation would shift to the time when such preference shares are redeemed. In addition, the fixed rate of dividend, which will be received every year will be considered as normal dividend and there would qualify for deduction u/s 80 L subject to a, maximum o Rs.9000, E.g. Marico 1ndustris bonus preference share issue.

The companies resort to resource mobilization by way of issue of equity capital and the companies have to follow necessarily the provisions of section 81 of the Companies Act, l956. In such

an event the shareholders may or may not avail the rights given to them for subscribing to the additional capital. Further in pricing the issue of shares, the shares can be issued at par or at a premium. Since these shares are subscribe with receipt of cash consideration n mind, they cannot be deemed as dividend even though it may confer some pecuniary advantage to the shareholders in terms of the ruling market prices Since the renouncement right is there, the amount pecuniary advantage cannot be taxed. Therefore the rights issue offers an excellent scope for tax planning by the shareholders. In case the rights are renounced in favour of one of the family members and such family member takes up the share, the pecuniary advantage is passed on to the member of the family. In case such transferee is a minor the clubbing provision can also be avoided.

Tax Credit for tax paid on 'Book Profits'.

Under section 15JB in the case of a company, the income-tax, payable on the total income as computed under this Act in respect of any assessment year, is less than ten per cent of its 'book profit', such book profit is deemed to be the total income of the company and the tax is payable by the company on such 'book profit' shall be the amount of income-tax at the rate of ten per cent.

Tax credit in respect of tax paid on deemed income relating to certain companies.

Section 115JAA provides that when any tax is paid under section 115JB by any company for the assessment year commencing on the 1st day of April, 2006 and any subsequent assessment year, then, credit in respect of tax so paid shall be allowed to him in accordance with the provisions of this section.

The tax credit to be allowed is the difference of the tax paid for any assessment year under section 115JB and the amount of tax payable by the assessee on his total income computed in accordance with the other provisions of this Act.

The tax credit shall be allowed set-off in a year when tax becomes payable on the total income computed in accordance with the provisions of this Act other than on 'book profits'.

Set off in respect of brought forward tax credit shall be allowed for any assessment year to the extent of the difference between the tax on his total income and the tax which would have been payable under the provisions of section 115 JB.

The amount of tax credit determined under section 115JAA can not be carried forward and set off beyond the seventh assessment year immediately succeeding the assessment year in which tax credit becomes allowable under section.

However, no interest shall be payable on the tax credit allowed under section 115 JAA.

When any company becomes liable for payment of tax on book profits', it should be ensured that an amount of tax credit should be ascertained and credit should be availed in terms of these provisions.

TAX ON DISTRIBUTED PROFITS OF A COMPANY

The amount declared, distribution or paid by a domestic company way of dividends (DDT) would be charged to additional income-tax at a flat rate of 15% (increased by surcharge @2% on I.T, 2% education cess and 1% secondary education cess on I.T. plus S.C..) in addition to normal income tax chargeable on the income of the company.

As per provisions of section 115-O a domestic company is liable to pay tax on any amount declared, distributed or paid by such company by way of dividends, whether interim or otherwise.

Notwithstanding that no income-tax is payable by a domestic company on its total income computed in accordance with the provisions of this Act, the tax on distributed profits must be paid.

The principal officer of the company and the company would be liable to pay income tax to the credit of Central Government within 14 days from the declaration, distribution, or payment of dividends whichever is the earliest. If the principal officer and the company fail to so pay the income-tax to the credit of the Central Government, he or it will be liable to pay simple interest at the rate of 1%, for every month or part of thereof on the amount of tax payable and such principal officer and the company would also be deemed to be assessee in default in respect of the amount of tax payable.

It has been clarified that no deduction under any of the provisions of the IT Act would be allowed to the company or shareholders in respect of the tax on distributed profits. The additional income-tax so paid by the company would be treated as the final payment of tax in respect of the amount distributed and no further credit for such tax would be claimed either by the company or by any other assessee. The provision is logical as the entire amount of such dividends would completely exempt from the income-tax in the hands of shareholders, under section 10(33).

TAX ON DISTRIBUTED INCOME TO UNIT-HOLDER

Chapter XlI-D includes three Sections 115R , 115S and 115T which provide for

Tax on distributed income to unit holders is applicable under section 115T. Any amount of income distributed by UTI or a Mutual Fund to its unit holders shall be chargeable to tax and such UTI or Mutual Fund shall be liable to pay additional income-tax on such distributed income at the rate of—

(i) twenty-five per cent on income distributed by a money market mutual fund or a liquid fund;

(ii) twelve and one-half per cent on income distributed to any person being an individual or a Hindu undivided family by a fund other than a money market mutual fund or a liquid fund; and

(iii) twenty per cent on income distributed to any other person by a fund other than a money market mutual fund or a liquid fund:

Such Tax shall not apply to shall apply to any income distributed,—

(*a*) by the Administrator of the specified undertaking, to the unit holders; or

(*b*) to a unit holder of equity oriented funds in respect of any distribution made from such funds

Interest and penalty applies to any default in tax payment.

INCENTIVE TO VENTURE CAPITAL AND TAX TREATMENT OF INCOME OF A VENTURE CAPITAL COMPANY OR A VENTURE CAPITAL FUND

Section 10 (*23FA*) *of the Act exempts* any income by way of dividends, other than dividends referred to in section 115-O, or long-term capital gains of a venture capital fund or a venture capital company from investments made by way of equity shares in a venture capital undertaking in respect of any investment made after the 31st day of March, 2000.

In order to claim exemption the conditions should be fulfilled. Important provisions are as under :

i) such venture capital fund or venture capital company is approved, for the purposes of this clause, by the Central Government on an application made to it in accordance with the rules made in this behalf and which satisfies the prescribed conditions.

ii) any approval by the Central Government shall, at any one time, have effect for such assessment year or years, not exceeding three assessment years, as may be specified in the order of approval.

iii) "venture capital fund" means such fund, operating under a trust deed registered under the provisions of the Registration Act, 1908 (16 of 1908), established to raise monies by the trustees for investments mainly by way of acquiring equity shares of a venture capital undertaking in accordance with the prescribed guidelines;

iv) "venture capital company" means such company as has made investments by way of acquiring equity shares of venture capital undertakings in accordance with the prescribed guidelines;

v) "venture capital undertaking" means such domestic company whose shares are not listed in a recognised stock exchange in India and which is engaged in the—

(*i*) business of—

(*A*) software;

(*B*) information technology;

(*C*) production of basic drugs in the pharmaceutical sector;

(*D*) bio-technology;

(*E*) agriculture and allied sectors; or

(*F*) such other sectors as may be notified by the Central Government in this behalf; or

(*ii*) production or manufacture of any article or substance for which patent has been granted to the National Research Laboratory or any other scientific research institution approved by the Department of Science and Technology;

Section 10 (*23FB*)*of the Act exempts* any income any income of a venture capital company or venture capital fund *set up to raise funds for investment* in a venture capital undertaking.

In order to claim exemption the conditions should be fulfilled. Important provisions are as under :

(*a*) "venture capital company" means such company—

(*i*) which has been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992

(*ii*) which fulfils the conditions as may be specified, with the approval of the Central Government, by the Securities and Exchange Board of India, by notification in the Official Gazette, in this behalf;

(*b*) "venture capital fund" means such fund—

(*i*) operating under a trust deed registered under the provisions of the Registration Act, 1908 or operating as a venture capital scheme made by the Unit Trust of India established under the Unit Trust of India Act, 1963

(*ii*) which has been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992

(*iii*) which fulfils the conditions as may be specified, with the approval of the Central Government, by the Securities and Exchange Board of India, by notification in the Official Gazette, in this behalf; and

(*c*) "venture capital undertaking" means such domestic company whose shares are not listed in a recognised stock exchange in India and which is engaged in the—

(i) business of—

*(*A*) nanotechnology;*

*(*B*) information technology relating to hardware and software development;*

(C) *seed research and development;*

(D) *bio-technology;*

(E) *research and development of new chemical entities in the pharmaceutical sector;*

(F) *production of bio-fuels;*

(G) *building and operating composite hotel*-cum-*convention centre with seating capacity of more than three thousand; or*

(H) *developing or operating and maintaining or developing, operating and maintaining any infrastructure facility as defined in the* Explanation *to clause* (i) *of sub-section (4) of section 80-IA; or*

(ii) *dairy or poultry industry;*

WEALTH TAX

CHARGEABILITY

The wealth tax Act, 1957 extends to the whole of India and came into force on the 1st day of April 1957. The act was extended to the state of Sikkim with effect from the assessment year 1990-1991. Every individual, HUF or company shall be charged wealth tax at 1% on the net wealth in excess of Rs. 15 Lakhs determined on the basis of nationality and residential status on the corresponding valuation date.

"Net wealth includes assets / deemed assets irrespective of their location minus debt owed in respect of acquiring such assets. According to section 6, the value of the assets and debts located outside India shall not be included in the computation of net wealth of the assessee in certain cases dependant upon the nationality and residential status in the case of individuals and residential status in India in respect of HUF and companies.

- **CERTAIN IMPORTANT DEFINITIONS**

Under the Wealth Tax Act, 1957 certain terms have been defined for the purpose of computation of wealth and payment of tax, while certain have terms have evolved. Meaning of selected terms is as follows:

"Individual" means and includes trustees, trade unions, Hindu deities, holder of an impartible estate, and heirs of an individual who died intestate, association of persons where the shares are indeterminate. However club is not an individual.

"Hindu undivided family (HUF)" - the word has not been defined under the Act. This would mean that the word has to be construed in the same sense in which it is understood under the 1-lindu Law. Jam and Sikh families are not governed by Hindu Law even though they are treated as HUF under the Act. If the Karta of HUF dies, the HUF does not cease to exist. The share of the Karta devolves on the heirs and will be assessed in their individual hands. The remaining property will continue to be assessed in the hands of HUF.

"Company" shall have the meaning assigned to it in section 2 (17) of the Income-tax Act, 1961.

"Valuation date" in relation to any year for which an assessment is to be made tinder this Act means the last day of the previous year as defined u/s 3 of the Income-tax Act i.e. 31st March. Only the net wealth at the last moment of the last date should be considered for the purpose.

"Assessment year" means a period of twelve months commencing on the 1st day of April every year.

"Assessee" means a person by whom wealth tax or any other sum of money is payable tinder this Act and includes every person in respect of whom any proceeding tinder this Act has been taken for the determination of wealth tax payable by him or by any other person or the amount of refund due to him or such other person, every person who is deemed to be an assessee or assessee in default under this Act.

"Valuation Officer" means a person appointed as a Valuation Officer under section 12A, and includes a Regional Valuation Officer, a District Valuation Officer, and an Assistant Valuation Officer;

"Net wealth" means the amount by which the aggregate value computed in accordance with the provisions of this Act of all the assets, wherever located, belonging to the assessee on the valuation date, including assets required to be included in his net wealth as on that date under this Act, is in excess of the aggregate value of all the debts owed by the assessee on the valuation date which have been incurred in relation to the said assets;

"Location of the assets" is essentially one of fact and will have to be decided in the light of evidence. The following instructions have been issued:

1. Tangible immovable property is located in India if the property is in India.
2. Rights or interests in or over immovable property are located in India in respect of immovable properties located in India.

3. Rights or interests in or over tangible movable security are located in India if such property is located in India. Goods on high seas cannot be said to be located in India.

4. Debts, secured or unsecured, are located in India if they are contracted o be repaid in India or if the debtor is residing in India.

5. Aircraft or motorcar is located in India if they are registered in India.

The above list is only illustrative and not exhaustive and generally the location has to be decided having regard to the nature of the assets.

"Assets", means the following -

1. House including farmhouse means any building or land appurtenant thereto whether used for residential or commercial purposes or for the purpose of maintaining a guest house or otherwise including a farm house situated within twenty-five kilometers from local limits of any municipality or a Cantonment Board, but does not include—

   a) a house meant exclusively for residential purposes and which is allotted by a company to an employee or an officer or a director who is in whole-time employment, having a gross annual salary of less than five lakh rupees;

   b) any house for residential or commercial purposes which forms part of stock-in-trade;

   c) any house which the assessee may occupy for the purposes of any business or profession carried on by him;

   d) any residential property that has been let-out for a minimum period of three hundred days in the previous year;

   e) any property in the nature of commercial establishments or complexes;

2. Motor car – All motorcars, Indian or Foreign except cars used by the assessee in the business of running them on hire or as stock-in-trade;

3. Jewellery, bullion, furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals :(other than stock-in-trade)

4. Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes);

5. Urban land;

6. Cash in hand, in excess of fifty thousand rupees, of individuals and Hindu undivided families and in the case of other persons any amount not recorded in the books of account.

Explanation [1] - for the purposes of this clause -

(a) "Jewellery" includes-

(i) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones, and whether or not worked or sewn into any wearing apparel ;

(ii) precious or semi-precious stones, whether or not set in any furniture, utensils or other article or worked or sewn into any wearing apparel ;

(b) "Urban land" means land situate-

(i) in any area which is comprised within the jurisdiction of a municipality or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the valuation date; or

(ii) in any area within such distance, not being more than eight kilometres from the local limits of any municipality or cantonment board, as the Central Government may, having regard to the extent of, and scope for, urbanisation of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette.

The following land shall not be treated as urban land and not included as assets:

a) Land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated or

b) The land occupied by any building which has been constructed with the approval of the appropriate authority or

c) Any unused land held by the assessee for industrial purposes for a period of two years from the date of its acquisition by him or

d) Any land held by the assessee as stock-in-trade for a period of ten years from the date of its acquisition by him.

Explanation 2 - For the removal of doubts, it is hereby declared that "jewellery" does not include the Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government;

COMPUTATION LOGIC

Confirm that the assessee is an assessee liable for wealth tax under the Act i.e.

(i) individual,

(ii) HUF or

(iii) company.

The 'Net wealth' means the amount by which the aggregate value computed in accordance with the provisions of this Act all the assets, within the meaning of the Act, wherever located owned by the assessee on the valuation date, including assets required to be included in his net wealth as on the date of valuation date, is in excess of the aggregate value of all debts owed by the assessee on the valuation date owed by the assessee on the valuation date, which have been incurred in relation to the aforesaid assets. The same can be described as under:

Computation of the net wealth on the valuation date:

Sr. No.	Particulars	Rupees	Remarks
1	Value of the assets owned by the assessee	**XXXX**	Refer section 2 (e) for definition of 'asset' and Valuation Rules
2	Add : Share in Assets of Partnership, AOP, BOI, etc	**XXX**	
3	Add: Assets to be Clubbed	**XX**	Refer section 4 for assets of other persons to be included in wealth of a person
4	Sub- total	**XXXXXXXXX**	
5	Less: Assets exempt from Wealth Tax	**XXX**	Refer section 5
6	Sub total	**XXXXXX**	
7	Less: Debts incurred	**XX**	Refer section 2 (m) for definition of
8	Net Wealth	**XXXXX**	Refer section 44C rounding off ('00)

It, therefore, follows that wealth tax is chargeable only in the case of three categories of persons i.e. individuals, HUF and companies and in the case of individual on the basis of his nationality and residential status of previous year ending on the valuation date and in the case of HUF and company, on the basis of its residential status of the previous year ending on the valuation date.

DEEMED WEALTH : SECTION 4

The following assets even though owned by others shall be included in computation of net wealth of an individual.

1. Transfer to spouse/ son's wife – Sec. 4 (1)(a)

i) Asset held by the spouse of such individual to whom such assets have been transferred by the individual, directly or indirectly, otherwise than for adequate consideration or in connection with an agreement to live apart, or

ii) Asset held by a person or association of persons to whom such assets have been transferred by the individual directly or indirectly otherwise than for adequate consideration for the immediate or deferred benefit of the individual, his or her spouse or

iii) Asset held by the son's wife, of such individual, to whom such assets have been transferred by the individual, directly or indirectly, on or after the 1st day of June, 1973, otherwise than for adequate consideration, or

iv) Asset held by a person or association of persons to whom such assets have been transferred by the individual, directly or indirectly, on or after the 1st day of June, 1973, otherwise than for adequate consideration for the immediate or deferred benefit of the son's wife, of such individual or both.

2. Clubbing of minor's wealth – Sec. 4 (1)(a)

Asset held by a minor child, not being a minor child suffering from any disability of the nature specified in section 80U of the Income-tax Act or a married daughter, will be clubbed in the hands of the parent as indicated below:

a) Where the marriage of his parents subsists, in the hands of the person whose net wealth (excluding the minor's assets) is greater.

b) Where the marriage does not subsists, in the hands of the parents who maintains the child.

However, assets acquired by the minor out of his income reffered to in the proviso to sec. 64 (1A) of the Income - tax Act and which are held by him on the valuation date cannot be clubbed.

3. Interest in the assets of Firm or AOP – Sec. 4 (1)(b)

Where the assessee is a partner in a firm or a member of an association of persons (not being a co-operative housing society) the value of his (interest in the assets of the firm) or association is included in the net wealth of the assessee.

Provided that where a minor is admitted to the benefits of partnership in a firm, the value of the interest of such minor in the firm, determined in the manner specified above, shall be included in the net wealth of the parent of the minor in the manner stated above.

4. Transfer or conversion by member of HUF – Section 4 (1A)

Where, in the case of an individual being a member of a Hindu undivided family, any property having been the separate property of the individual has, at any time after the 31st day of December, 1969, been converted by the individual into property belonging to the family directly or indirectly, to the family otherwise than for adequate consideration, then, for the purpose of computing the net wealth of the individual under this Act for any assessment year commencing on or after the 1st day of April, 1972, it shall be included in the net wealth of such individual.

However, any property, on being included in the net wealth of the individual, it will be excluded from the net wealth of the family,

5. Assets transferred under a revocable transfer – Sec. 4 (5)

The value of any assets transferred under an irrevocable transfer shall be liable to be included in computing the net wealth of the transferor as and when the power to revoke arises to him. This implies that the value of any asset transferred under a revocable transfer shall be liable to be included in computing the net wealth.

Revocable transfer means the following transfers in accordance with explanations to Sec. 4

a) Transfers revocable within a period of 6 years.

b) Transfers revocable during the lifetime of the transferee.

c) Transfers where the assessee continues to derive the benefit from the asset directly or indirectly.

d) Transfer of an asset where the transfer deed provided for the retransfer of either the income or the asset to the assessee.

e) Transfer of an asset where the transfer deed gives the transferor assessee a right to reassume power over the asset or the income.

6. Gift by book entries - Sec. 4 [5A]

Gift of money by book entries made in the books maintained by the assessee to any other person with whom he has business relationship or ally other relationship it shall be deemed to be his asset unless the Assessing Officer is satisfied that money has actually been delivered to the other person at the time the entries were made.

7. Impartible Estate - Sec. 4[6]

Holder of an impartible estate shall be deemed to be the individual owner of all the properties comprised in the estate.

8. Building allotted by Housing Society- sec. 4[7]

Where the assessee is a member of a cooperative housing society or a company or ally association of persons to whom a building or part thereof is allotted or leased to him under a house-building scheme, the assessee is deemed to be the owner of such building or part thereof. In determining the value of such building any outstanding installments payable by tile assessee to the society towards the cost of such building or part thereof shall be deductible as debts owed by the assessee.

9. Possession of building by a contract u/s 53A of Transfer of Property Act - S.4[8]

Any person who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882, shall be deemed to be the owner of that building or part thereof and the value of such building or part shall be included in computing net wealth of such person.

10. Rights acquired under clause iii of S. 269UA of the Income-tax Act - S. 4[8]

Any person who acquires any rights (excluding any rights by way of a lease from month to month or for period not exceeding 1 year) in or with respect to any building or part thereof by virtue of any such transaction as is referred to in clause (f) of sec. 269 UA of the Income-tax Act, 1961, shall be deemed to be the owner of that building or part thereof and tile value of such building or part shall be included in computing net wealth of such person.

EXEMPTIONS IN RESPECT OF CERTAIN ASSETS

Wealth-tax shall not be payable by a non-resident assessee in respect of the assets situated outside India.

Wealth-tax shall not be payable by virtue of provisions contained in section 5 of the Act, by an assessee in respect of the following assets, and such assets shall not be included in the net wealth of the assessee –

(i) any property held by him under trust or other legal obligation for any public purpose of a charitable or religious nature in India i.e. excluding assts of business, other than business referred to in sub-section 10 (22), 10 (22A), (23B) and (23C) and 11(4A)(a) / (b);

(ii) the interest of the assessee in the coparcenary property of any Hindu undivided family of which he is a member ;

(iii) Any one Building used as official residence in the case of a ruler;

(iv) Jewellery in the possession of a ruler recognised as his heirloom at the time of his first assessment to wealth-tax under this Act :

Provided that in the case of jewellery recognised by the Central Government as aforesaid, such recognition shall be subject to the following conditions, namely:-

a) that the jewellery shall be permanently kept in India and shall not be removed outside India except for a purpose and period approved by the Board ;

b) that reasonable steps shall be taken for keeping the jewellery substantially in its original shape ;

c) that reasonable facilities shall be allowed to any officer of Government authorised by the Board in this behalf to examine the jewellery as and when necessary ; and

d) that if any of the conditions hereinbefore specified is not being duly fulfilled, the Board may, for reasons to be recorded in writing, withdraw the recognition retrospectively

(v) In the case of an assessee, being a person of Indian origin or a citizen of India who was ordinarily residing in a foreign country and who, on leaving such country, has returned to India with the intention of permanently residing therein, moneys and the value of assets brought by him into India and the value of the assets acquired by him out of such moneys within one year immediately preceding the date of his return and at any time thereafter:

This exemption shall apply only for a period of seven successive assessment years commencing with the assessment year next following the date on which such person returned to India.

(vi) one house or part of a house or a plot of land belonging to an individual or a Hindu undivided family:

Provided that wealth-tax shall not be payable by an assessee in respect of an asset being a plot of land comprising an area of five hundred square metres or less

Even where a building consists of more than one dwelling unit, if there is unity of structure exemption can be claimed for the entire building by treating it as one house. The fact that such self-contained dwelling units are occupied by different persons will not make any difference- Shiv Narain Chaudhari Vs CWT 108 ITR 104 (All).

If part of the house is used as a godown and the remaining part is used for residence even then the exemption can be claimed for the entire house including the godown – CWT Vs M Appuswamy 233 ITR 460 (Mad).

In order to avail exemption u / s 5 (1), it is not necessary that the property must be held in India but it is necessary that the public purpose of charitable or religious nature should be in India. If

property is held in India but it is held for any public purpose of a charitable or religious nature outside India, the trust does not qualify for exemption – Trustees of H.E.H. The Nizam's pilgrimage money Trust Vs CIT 243 ITR 676 (SC)

Under a trust deed the purpose for which the trust property would be put to use were not confined to religious or charitable use; the property could be used for social, cultural and other allied purpose at the sole discretion of the trustee. Such a trust was held to be not entitled to exemption under section 5 (1) of the Wealth Tax Act- Ganga Bai Charities Vs CWT 2501 ITR 666 (SC).

EXCLUSIONS

In the case of a foreign citizen, foreign company and an individual or HUF not ordinarily resident in India / NRI, the following assets shall not be considered :

(i) Value of assets and debts located outside India.

(ii) Value of assets in India represented by loans or debts owed by the assessee the interest whereon is exempt Ws 10 of the Income-tax Act. The nature of the assets under this category is: NRE deposits, FCNR deposits and bonds / debentures / deposits, the interest on which is exempt u / s 10(4) / (4B) and 10(15). Since deposits / bonds and debentures are not treated as taxable assets with effect from assessment year 1993-94, this provision is only of academic interest.

The net wealth of the following entities shall not be taxed under the Act:

1) Companies registered u / s 25 of the Companies Act.

2) Any cooperative society.

3) Any social club.

4) Any political party.

5) Any mutual fund [Covered by section 10(23D)].

Partnership firms, AOP, BOI are not liable for wealth tax on their net wealth. However, their net wealth is computed as per provisions of the act and the share of partner being individual, HUF or company is included in the net wealth of the said person.

SCOPE OF NET WEALTH

The scope of Net Wealth in the case of the three assessees is as under -

	Whether to be included		**Whether to be deducted**	
	Assets located in India	Assets located outside India	Debts located in India	Debts located outside India
In case of Indian National				
- Resident & ordinarily resident	Yes	Yes	Yes	Yes
- Resident but not ordinarily resident	Yes	No	Yes	No
- Non-resident	Yes	No	Yes	No
In case of Foreign National				
In case of Foreign National	Yes	No	Yes	No
In the case of HUF				
- Resident & ordinarily resident	Yes	Yes	Yes	Yes
- Non-resident or resident but not ordinarily resident	Yes	No	Yes	No
In the case of Company				
- Resident	Yes	Yes	Yes	Yes
- Non-Resident	Yes	No	Yes	No

VALUATION OF ASSETS SECTION

The value of any asset, other than cash, for the purposes of this Act, shall be determined in the manner laid down in these rules. Section 7 prescribes that the valuation should be in accordance with Schedule III to the Act.

Valuation of immovable property

Subject to the provisions of rules 4, 5, 6, 7 and 8, for the purposes of sub-section (1) of section 7, the value of any immovable property, being a building or land appurtenant thereto, or part thereof, shall be the amount arrived at by multiplying the net maintainable rent by the figure 12.5 :

In relation to any such property which is constructed on leasehold land, this rule shall have effect as if for the figure 12.5,—

(*a*) where the unexpired period of the lease of such land is fifty years or more, the figure 10.0 had been substituted ; and

(*b*) where the unexpired period of the lease of such land is less than fifty years, the figure 8.0 had been substituted **:**

Net maintainable rent how to be computed.

For the purposes of rule 3, "net maintainable rent" in relation to an immovable property referred to in that rule, shall be the amount of gross maintainable rent as reduced by—

(*i*) the amount of taxes levied by any local authority in respect of the property ; and

(*ii*) a sum equal to fifteen per cent of the gross maintainable rent.

Gross maintainable rent how to be computed.

For the purposes of rule 4, "gross maintainable rent", in relation to any immovable property referred to in rule 3, means—

(*i*) where the property is let, the amount received or receivable by the owner as annual rent or the annual value assessed by the local authority in whose area the property is situated for the purposes of levy of property tax or any other tax on the basis of such assessment, whichever is higher;

(*ii*) where the property is not let, the amount of annual rent assessed by the local authority in whose area the property is situated for the purpose of levy of property tax or any other tax on the basis of such assessment, or, if there is no such assessment or the property is situated outside the area of any local authority the amount which the owner can reasonably be expected to receive as annual rent had such property been let.

The computation logic for the valuation of the building is as under:

Annual rent or annual value assessed		
Actual rent received *I* receivable	XX	
Gross maintainable rent		**XXX**
Less: Amount of Tax levied	XX	
15% of the gross maintainable rent	XX	
Net Maintainable rent (NMR)		**XXX**
Valuation by capitalization:		
A. Property on freehold land: NMR * 12.50		XXX
B. Property on leasehold land:		
Unexpired lease period 50 years or more: NMR * 10		XXX
Unexpired lease period less than 50 years: NMR * 8		XXX
Value adjustments:		
Add:		
(a) If the un-built area of the plot of land exceeds a specified area		
(i) Above 5% up to 10% — 20% of the above value		
(ii) Above 10% up to 15% —30% of the above value		XXX
(iii) Above 15% up to 20% — 40% of the above value		
Less: Deduction towards claim and recovery of specified part of the unearned increase in the value of the land at the time of transfer of the property or 50% of Schedule Ill value, whichever is less (In the case of property constructed on leasehold land).		XXX
Valuation of property for Wealth Tax		XXX

Notes:

1. Aggregate area means the aggregate of area on which the property is constructed and the unbuilt area.

2. The unbuilt area means that part of such aggregate area on which no building has been erected.

3. Specified area in relation to properties located in:

i)	Mumbai, Kolkata, Delhi or Chennai	— 60% of the aggregate area
ii)	Agra, Ahmedabad, Allahabad, Amritsar, Bangalore, Bhopal, Cochin, Hyderabad, Indore, Jabalpur, Jamshedpur. Kanpur, Lucknow, Ludhiana, Madurai, Nagpur, Patna, Pune, Salem, Sholapur, Srinagar, Surat, Tiruchirapalli, Trivandrum, Vadodara or Varanasi	— *65%* of the aggregate area
iii)	Any other place	— 75% of the aggregate area

4. Unearned increase means the difference between the value of the land on the valuation date (determined by the Government or other authority) and the amount of the premium paid / payable to the Government for the lease of the land.

5. Where the difference between unbuilt area and specified area exceeds 20% of the aggregate area and where the lease period expires within 15 years, rule 20 will apply.

Valuation of assets of business

In case of accounts of the business are maintained regularly, value of assets as disclosed in the balance sheet shall be taken as follows:

(*a*) the value of any asset as disclosed in the balance-sheet shall be taken to be,—

(*i*) in the case of an asset on which depreciation is admissible, its written-down value;

(*ii*) in the case of an asset on which no depreciation is admissible, its book value;

(*iii*) in the case of closing stock its value adopted for the purposes of assessment under the Income-tax Act for the previous year relevant to the corresponding assessment year;

Net value of the assets as per the Balance Sheet		XXX
Add. Value of assets not disclosed in the Balance Sheet		XXX
Less:		
1. Advance Tax paid	XX	
2. Bad Debts allowed as deduction	XX	
3. Assets on which wealth tax is not payable	XX	
4. Debit balance of P&L account	XX	
5. Non-business assets	XX	
6. Capital employed other than borrowed fu	XX	
7. Reserves	XX	
8. Any provision for meeting future *I* contingent liability	XX	
9. Non-business liabilities	XX	
10. Liability for financing exempt assets	XX	
		XXX
Value of business		**XXX**

Where it is not possible to calculate the amount of debt so utilised, it shall be taken as the amount which bears the same proportion to the total of the debts owed by the assessee as the value of that asset bears to the total value of the assets of the business.

Valuation of Interest in firms and Association of Persons

The value of the interest of a person in a firm of which he is a partner or in an association of persons of which he is a member shall be determined in the manner:

Computation of net wealth of the firm or association and its allocation amongst the partners or members

STEP I : Compute the net wealth of the firm / AOP (Rule 14).

STEP 2 : The net wealth determined in step 1 shall be without considering exemptions u/s 5(1) / 5(IA).

STEP 3 : Allocate the net wealth to the extent of capital contribution amongst the partners in proportion to their capital contribution.

STEP 4 : Allocate the residual wealth in line with agreement for distribution of assets in the event of dissolution / profit sharing ratio.

STEP 5 : Include the value of interest of the partner *I* member in respect of assets eligible for exemption u/s *5(1)* / 5(1A) in the profit sharing ratio.

Valuation of Personal Assets — Jewellery

The value of the jewellery shall be the open market price on the valuation date. **The return of net wealth furnished by the assessee shall be supported by,—**

i) a statement in the prescribed form, where the value of the jewellery on the valuation date does not exceed rupees five lakhs;

ii) a report of a registered valuer in the prescribed form, where the value of the jewellery on the valuation date exceeds rupees five lakhs.

Notwithstanding anything mentioned in sub-rule (2), the Assessing Officer may, if he is of opinion, that the value of the jewellery declared in the return,—

(*a*) is less than its fair market value by such percentage or such amount as is prescribed under sub-clause (*i*) of clause (*b*) of sub-section (1) of section 16A;

(*b*) is less than its fair market value as referred to in clause (*a*) of sub-section (1) of section 16A,

he may refer the valuation of such jewellery to a Valuation Officer under sub-section (1) of the said section and the value of such jewellery shall be the fair market value as estimated by the Valuation Officer.

Where the jewellery includes gold or silver or any alloy of these, then the value of these metals as on the valuation date shall be substituted for the value a determined by the officer. Where any jewellery is sold or disposed off or where jewellery i acquired, the value of jewellery as determined shall be reduced or increased to the extent of such deletions or additions to the jewellery

Valuation of Life Interest

STEP I : Compute the average of the annual gross income in the last three years.

STEP 2 : Reduce the average of the collection expenses incurred in each of those three years subject to a maximum of *5%* of the average of the annual gross income.

STEP 3 : Multiply the annual average income arrived in step 2 with the value factor given in the table against the age of the assessee, which will give the value of life interest on the valuation date.

STEP 4 : The value factors arrived at on the basis of formula based on annual premium for whole life insurance without profits.

STEP *5* : Where the life tenant has to be insured at higher premium rates, the Assessing Officer may vary the valuation suitably.

STEP 6 : The value of life interest shall be limited to the market value of the trust corpus on the valuation date.

STEP 7 : Where the life tenant is 80 years or above, treat the value as NIL.

Valuation of Residuary Assets

The value of any asset not covered above shall be the estimated price, which it would fetch in the open market on the valuation date. This is irrespective of any documents available showing the cost of acquisition (Rule 20 & 21).

Tax Planning Aspects

The following are not considered as 'assets' for computation of net worth

1. In the case of any person only cash in hand is treated as an asset. Balance in Bank account will not be treated as assets. Therefore, the cash in hand should be deposited in bank before the valuation date and can be withdrawn after the valuation date.
2. In the case of ownership of yatches, boats and air crafts, they are included in the net wealth. Ships are kept out side purview.
3. The land on which construction of building is not permissible under any law for the time being in force in the area in which such land is situated.
4. The land occupied by a building, which has been constructed with the approval of the appropriate authority
5. One residential house is exempt. In case of two or more houses, possibility of its gift / sale to any family member may be considered.
6. Any unused land by the assessee for industrial purposes for period of more than 2 years from the date of acquisition.
7. Any land held as stock in trade for a period of more than 10 years from the date of its acquisition.
8. Jewellery shall not include gold deposit bonds issued under the Gold deposit scheme.
9. Any residential property that has been let out for a minimum period of 300 days in the previous year.
10. Any property in the nature of commercial establishments or complexes.
11. Cars used by the assessee in the business of running them on hire shall be excluded.
12. Cars held as stock in trade by the manufacture or dealer.
13. In case of non-residents assets outside India are not liable to wealth tax.

Avoidance of tax by certain transactions in securities

Provisions are made for arresting avoidance of tax from certain transactions in securities. Care should be taken that the company avoids such transactions. However, if these transactions are entered into; then proper computation from such transactions should be reported. Important transactions are as under:

Transactions in securities:

1. Where the owner of any securities sells or transfers those securities and buys back or reacquires the securities, then, if the result of the transaction is that any interest becoming payable in respect of the securities is receivable otherwise than by the owner, the interest payable as aforesaid shall, whether it would or would not have been chargeable to income-tax apart from the provisions of this sub-section, be deemed, for all the purposes of this Act, to be the income of the owner and not to be the income of any other person.

2. Where any person has had at any time during any previous year any beneficial interest in any securities, and the result of any transaction relating to such securities or the income thereof is that, in respect of such securities within such year, either no income is received by him or the income received by him is less than the sum to which the income would have amounted if the income from such securities had accrued from day to day and been apportioned accordingly, then the income from such securities for such year shall be deemed to be the income of such person.

3. The provisions stated in para 1 or 2, above shall not apply if the owner, or the person who has had a beneficial interest in the securities, as the case may be, proves to the satisfaction of the Assessing Officer that

   (*a*) there has been no avoidance of income-tax, or

   (*b*) the avoidance of income-tax was exceptional and not systematic and that there was not in his case in any of the three preceding years any avoidance of income-tax by a transaction of the nature referred to in para 1 or 2.

4. Where any person carrying on a business which consists wholly or partly in dealing in securities, buys or acquires any securities and sells back or retransfers the securities, then, if the result of the transaction is that interest becoming payable in respect of the securities is receivable by him but is not deemed to be his income by reason of the provisions contained in sub-section (1), no account shall be taken of the transaction in computing for any of the purposes of this Act the profits arising from or loss sustained in the business.

Dividend Stripping:

Where—

(*a*) any person buys or acquires any securities or unit within a period of three months prior to the record date;

(*b*) such person sells or transfers—

   (*i*) such securities within a period of three months after such date; or

   (*ii*) such unit within a period of nine months after such date;

(*c*) the dividend or income on such securities or unit received or receivable by such person is exempt, then, the loss, if any, arising to him on account of such purchase and sale of securities or unit, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or unit, shall be ignored for the purposes of computing his income chargeable to tax.

Bonus Stripping:

Where—

(*a*) any person buys or acquires any units within a period of three months prior to the record date;

(*b*) such person is allotted additional units without any payment on the basis of holding of such units on such date;

(*c*) such person sells or transfers all or any of the units referred to in clause (*a*) within a period of nine months after such date, while continuing to hold all or any of the additional units referred to in clause (*b*), then, the loss, if any, arising to him on account of such purchase and sale of all or any of such units shall be ignored for the purposes of computing his income chargeable to tax and notwithstanding anything contained in any other provision of this Act, the amount of loss so ignored shall be deemed to be the cost of purchase or acquisition of such additional units referred to in clause (*b*) as are held by him on the date of such sale or transfer.

CLUBBING PROVISIONS :

INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME

Under the Income-tax Act, 1961, an assessee is generally liable to tax in respect of the income he earns. The anxiety of saving tax renders assessee to take up such transactions that his income is reduced and that to his family members increases, However, in order to arrest such a tax planning, provisions are made for inclusion of family members income in the income of an assessee under certain circumstances.

The provisions have also been made to counteract the tendency on the part of the tax-payers to dispose of the property or transfer income in such a way that their tax liability can be avoided or reduced. These are popularly called as clubbing provisions. Important provisions are as under:

Section	Person whose income to be clubbed	Nature of income to be clubbed	Person in whose hands to be clubbed
64(1)(ii)	Spouse	Salary, commission, fees, remuneration from concern where individual has substantial interest. If spouse possesses technical / professional qualification and income is solely attributable to the application of such knowledge, it is not to be clubbed.	Spouse having substantial interest in the concern
64(1)(iv)	Spouse	From assets transferred to spouse for inadequate consideration other than (i) transfer under an agreement to live apart, or (ii) an income from house property includible u / s. 27(i), interest on capital contributed in the firm out of the transferred funds will however, be clubbed.	Transferor
64(1)(vi)	Son's wife	From assets transferred (after 1-6-1973) to son's wife for inadequate consideration. Interest on capital contributed in the firm out of the transferred funds will however be clubbed.	Transferor
64(1)(vii)	Spouse	Income for immediate or deferred benefit of spouse from assets transferred for inadequate consideration to an AOP or a person.	Transferor

4(1)(viii)	Son's wife	Income for immediate or deferred benefit of son's wife from assets transferred for inadequate consideration (after 1-6-1973) to an AOP or a person.	Transferor
4(1A)	Minor child (except a minor child suffering from any disability mentioned in S. 80U)	Any income accruing / arising to a minor, except income from: a)manual work, or b)application of his skill, or talent, or specialised knowledge and experience (for deduction refer note below)	1st year: that parent whose income is higher. Subsequent years; the same parent — unless the AO is satisfied that it should be clubbed with the other parent.
			where marriage does not subsist, in the hands of the custodian parent.
4(2)	HUF	Income from property converted to HUF property or transferred to HUF by an individual (after 31-12-1969) for inadequate consideration. If converted property is partitioned, income from partitioned property received by spouse, is clubbed in the hands of the individual.	Transferor

Note :Deduction of income up to Rs. 1,500 per minor is available [S. 10(32)]

Therefore, it needs to be ascertained that tax planning exercise is beyond the clubbing provisions. In case these provisions are attracted, it must be ensured that income of the other person is included in the assesse;s income for tax calculations.

DOUBLE TAXATION RELIEF

Some of the taxpayers having transactions with outside countries resort to dubious methods for evading their liability under the tax laws. Tax evasion is thus closely linked with transactions involving over-invoicing and under-invoicing in import and export business operations through secret foreign bank accounts and smuggling of valuable articles into and out of India. With a view to enabling the tax administration to tackle the problem of tax evasion having international ramifications, in order to empower the Central Government to enter into agreements with foreign countries not only for purposes of avoidance of double taxation of income but also for enabling the tax authorities to exchange information for the prevention of evasion or avoidance of taxes on income or for investigation of cases involving tax evasion or avoidance or for recovery of taxes in foreign countries on a reciprocal basis.

It is, therefore, necessary to examine such an agreement in case of cross-border transactions as relief is afforded by the Double Taxation Avoidance Agreement (DTAA). It provides a useful inputs for cross bordr tax planning.

Agreement with foreign countries [Sec 90]

(1) Where the Central Government may enter into an agreement with the Government of any country outside India for the granting of relief in respect of—

(*i*) Income on which have been paid both income-tax under this Act and income-tax in that country; or

(*ii*) income-tax chargeable under this Act and under the corresponding law in force in that country to promote mutual economic relations, trade and investment,

Advantage of such relief should be availed.

It should be noted that an agreement with any country for granting relief has been entered into, then, in relation to the assessee to whom such agreement applies, the provisions of the Income Tax Act apply to the extent they are more beneficial to that assessee.

Examples :

1. Rate of tax on say, Royalty is 10% as per the Act as well as the DTAA. In such a case surcharge and education cess is not applicable for rates prescribed in DTAA. Therefore, DTAA route should be selected.

2. Under India – Mauritious DTAA:

In respect of Capital Gains:

i. gains from the alienation of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, is be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

ii. Gains derived by a resident of a Contracting State from the alienation of any property other than those specifically mentioned in the other paragraphs, is be taxable only in that State.

3. Under India – USA DTAA

i) In case of 'salary' income of a Non-resident from USA, it is taxable in India if services are rendered in India. However, if period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, it is not taxable in India when certain further conditions are fulfilled.

ii) Income from Royalties or fees for technical services arising in India and paid to a beneficial owner of USA, the tax so charged in India shall not exceed 10 per cent of the gross amount of the royalties or fees for technical services.

Countries with which no agreement exists [Sec. 91]

If any person who is resident in India in any previous year proves that, in respect of his income he has paid tax in any other country with which there is no DTAA under section 90 for the relief or avoidance of double taxation, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

In the other words, where section 90 does not apply, unilateral relief will be available, which should be availed'

Conditions for such relief should be followed.

Income deemed to accrue or arise in India

Section 9 of the Income Tax Act, 1961 provides that certain incomes are presumed to accrue or arise in India irrespective of actual place of accrual or arising. Therefore, income tax is attracted and is payable on such incomes even by non-residents.

In case recipient of income is a non-resident, provisions of deduction of tax at source from such incomes (section 195) are attracted. However, if there is an agreement for avoidance of double taxation with the country of which the said non-resident recipient is a resident, concession stated in the DTAA becomes applicable. Concession can be sparing the income from tax in India or the foreign country, lower rate of tax, etc.

In view of these provisions, at times non-resident recipients demand payment on 'net' basis i.e. exclusive of Indian taxes. While undertaking such transactions care should be taken to measure correct cost of the outgo, else planning may fail.

The following incomes shall be deemed to accrue or arise in India :—

(*i*) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

(*ii*) income which falls under the head "Salaries", if it is earned in India.However, any pension payable outside India to a person residing permanently outside India shall not be deemed to accrue or arise in India, if the pension is payable to a person referred to in article 314 of the Constitution or to a person who, having been appointed before the 15th day of August, 1947, to be a Judge of the Federal Court or of a High Court within the meaning of the Government of India Act, 1935, continues to serve on or after the commencement of the Constitution as a Judge in India.

(*iii*) income chargeable under the head "Salaries" payable by the Government to a citizen of India for service outside India ;

(*iv*) a dividend paid by an Indian company outside India ; however, under section 10(34) any corporate dividend referred to in section 115O is exempt from tax.

(*v*) income by way of interest payable by—

(*a*) the Government ; or

(*b*) a person who is a resident (Exception : where the interest is payable for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India)

(*c*) a person who is a non-resident, where the interest is payable for the purposes of a business or profession carried on by such person in India ;

(*vi*) income by way of royalty payable by—

(*a*) the Government ; or

(*b*) a person who is a resident, or

(*c*) a person who is a non-resident;

(*vii*) income by way of fees for technical services payable by—

(*a*) the Government ; or

(*b*) a person who is a resident, or

(*c*) a person who is a non-resident;

Note : in case of (v) interest, (vi) royalty and (vii) fees for technical services, stated above:

In case of (*b*) a person who is a resident the exception is where the interest is payable for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India, income is not deemed to accrue or arise in India.

and

In case of (*b*) a person who is a non-resident, where the interest is payable for the purposes of a business or profession carried on by such person in India ; income is not deemed to accrue or arise in India.

Income from property held for charitable or religious purposes

Income of charitable and religious trusts is exempt from tax under sections 11, 12 and 13. However, there ate certain conditions, compliance of which is necessary for availing exemption. While planning affairs of trust, these provisions should be complied with.

1. The exemption provisions of section 11 and 12 do not apply to any trust or institution unless an application for registration of the trust or institution is made to the Commissioner before the expiry of a period of one year from the date of the creation of the trust or the establishment of the institution'

2. The following income shall not be included in the total income of the previous year of the person in receipt of the income—

i) Income is exempt to the extent to which such income is applied to such purposes in India; and, where any such income is accumulated for application to such purposes in India. However, the income so accumulated or set apart should not be in excess of fifteen per cent of the income; in case of

(*a*) income derived from property held under trust wholly for charitable or religious purposes,

(*b*) If the trust is created before the commencement of the Income Tax Act, 1961, income derived from property held under trust in part only for such purposes,

ii) Income derived from property held under trust—

(*i*) created on or after the 1st day of April, 1952, for a charitable purpose which tends to promote international welfare in which India is interested, to the extent to which such income is applied to such purposes outside India, and

(*ii*) for charitable or religious purposes, created before the 1st day of April, 1952, to the extent to which such income is applied to such purposes outside India:

However, the CBDT approval is necessary

iii) Income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

Where eighty-five per cent of the income referred to in clause (*a*) or clause (*b*) of (i) above is not applied, to charitable or religious purposes during the previous year, it can be accumulated or set apart, either in whole or in part, for application to such purposes and tax can be avoided. Rules for such accumulation are :

(a) by notice in writing given to the Assessing Officer, the purpose and the period (not exceeding 5 years) for which the income is being accumulated.

(b) the money so accumulated is invested or deposited in the forms or modes specified for the purpose.

Exemption of charitable and religious trusts is forfeited if attendant conditions are not complied with. Important cases where, also, exemption is forfeited :

(a) Income is applied or ceases to be accumulated to purposes other than charitable or religious

(b) Income ceases to remain invested in any of the forms specified
(c) Income is not utilised for the purpose for which it is so accumulated
(d) any part of the income for private religious purposes which does not enure for the benefit of the public;
(e) in the case of a trust for charitable purposes or a charitable institution created or established after the commencement of this Act, any income thereof if the trust or institution is created or established for the benefit of any particular religious community or caste;
(f) if any part of such income or any property of the trust is used or applied directly or indirectly for the benefit of any trustee, his relatives, etc.

Care should be taken to avoid withdrawal of exemption.

INTEREST, PENALTY AND PROSECUTION

Interest and penalties are charged for non compliance of tax obligations and procedural formalities. Where there is substantial non compliance from assessee he is subjected to prosecution which can result into fine, imprisonment or both. In any case, these are extra levies which the assessee has to pay. Moreover no deduction is available from taxable income for such levies; therefore, it cost an extra burden on assessee. Therefore, care needs to be taken that organization is not exposed to any such levies.

Brief information about this is here under furnished –

INTEREST

It should be noted that rate of interest, in all the cases, is 1% for each month or part thereof. This interest is not deductible expenditure; therefore, the effective rate is much more, which depends upon the applicable tax rate.

Sections 234A, 234B and 234C provide for charging of mandatory interest since word 'shall' is used in the said sections. (CIT v. Anjum M.H. Ghaswala**)**

Interest For failure to deduct or pay any TDS [Sec. 201(A)]:

Where a person responsible for deducting tax at source does not deduct a source under Chapter XVII or after deducting tax fails to pay the same as required by Act, he is liable to pay interest on the amount of such tax from the date on which tax deductible till the date it is actually paid.

Interest For failure to collect any tax or pay TCS [Sec. 206C(7)] :

Where a person responsible for collecting tax at source under section 206C does not collect or after collecting tax fails to pay the same as required by Act, he is liable to pay interest on the amount of such tax from the date on which tax should have been collected till the date it is actually paid.

Interest On Delayed Payment Of Tax Other Than Advance Tax [Sec. 220(2)]

Where an assessee fails to pay any tax, penalty, etc. within 30 days from the date of the Notice of Demand issued under section.156, he shall be liable to pay interest on the outstanding demands for the period of default.

Interests for default in furnishing return [Sec. 234A]:

Under the Income-tax Act, interest is payable by the assessee in respect of non filing or delayed filing of return in certain cases, on outstanding self assessment tax.

For default in paying advance tax [Sec. 234B]:

Where an assessee who has failed to pay advance tax, interest is payable on assessed tax. Such interest is payable from April 1 of the assessment year to the date of determination of income under section 143(1) or on regular assessment.

Where an assessee who had paid advance tax but the amount of advance tax paid by him less than 90% of assessed tax, interest is payable on the assessed tax minus advance tax is paid. Such interest is payable from April 1 of assessment year upto the date of determination of income u/s/ 143(1) or on regular assessment.

Interest for Deferment Of Advance Tax [Sec. 234C]

An advance tax is said to have been deferred, if any one or more of the installments are not paid or tax paid is less than prescribed under the law interest is attracted.

INTEREST IS PAYABLE TO ASSESSEE ON REFUND [SEC. 244A]

Interest on excess payment of advance tax, tax deducted or collected at source and any other tax or penalty becoming refundable shall be paid @ 1/2% for every month or part of a month.

ROUNDING OFF OF MONTH [Rule 119A]

The interest is to be calculated, any fraction of a month deemed to be full month and the interest shall be so calculated.

ROUNDING OFF OF AMOUNT [Rule 119A]

The amount of tax, penalty or other sum in respect of which interest is to be calculated is to be rounded off to the nearest multiple of Rs. 100 and for this purpose any fraction of Rs. 100 is to be ignored.

PENALTIES & PROSECUTION
PENALTIES

Section	Nature of Default	Minimum Penalty	Maximum Penalty
158BFA	Undisclosed income determined by the Assessing Officer u/s.158BC(c)	100% of the tax on undisclosed income	300% of the tax on undisclosed income
221(1)	Default in making a payment of tax within prescribed time	Such amount as the Assessing Officer may impose	Tax in arrears
271(1)(b)	Failure to comply with a notice u/s. 142(1) or 143(2) or with a direction issued u/s.142(2A).	Rs.10000 for each failure	Rs. 25,000 for each failure. (upto 31.5.2001)
271(1)(c)	Concealment of the particulars of income or furnishing inaccurate particulars of income.	100% of Tax sought to be evaded.	300% of Tax sought to be evaded.
271A	Failure to keep or maintain books of A/c, document as required u/s.44AA.	Rs.25000	Rs.1,00,000
271AA	Failure to keep and maintain information and document in respect of international transaction.	a sum equal to two per cent of the value of each international transaction entered into by such person.	a sum equal to two per cent of the value of each international transaction entered into by such person.
271AAA	Penalty where search has been initiated	a sum computed at the rate of ten per cent of the undisclosed income of the specified previous year.	a sum computed at the rate of ten per cent of the undisclosed income of the specified previous year.

271B	Failure to get accounts audited u/s.44AB or to furnish such report along with return of income by due date	1/2% of Total Sales, Turnover or Gross receipts.	Rs.1,00,000
271C	Failure to deduct the whole or any part of tax u/s.192 to 195 or (w.e.f. 1.6.97) failure to pay the whole or any part of tax u/s.115 O(2) or 2nd proviso to sec. 194B.	Amount of Tax required to be deducted at source.	—
271CA	Penalty for failure to collect tax at source	a sum equal to the amount of tax	a sum equal to the amount of tax
271D	Taking or accepting any loan or deposit in contravention of the provisions of S.269 SS Repaying of any deposit otherwise than in accordance with the provisions of Sec. 269 T	Amt. of Loan/Deposit so taken or accepted Amount of deposit so repaid.	— —
271F	i)Failure to furnish return of income u/s.139(1) before the end of the relevant assessment year(w.e.f. 1.4.99) ii)Failure to furnish return of income as per proviso to Sec.139(1) by the end of relevant assessment year .	Rs.5000 Rs. 5000 for each default.	— Rs. 10,000 for each default
271FB	Penalty for failure to furnish return of fringe benefits	a sum of one hundred rupees for every day during which the failure continues.	a sum of one hundred rupees for every day during which the failure continues.

272A(1)(a)	Refuses to answer any question put to a person regarding his assessment by an I.T. Authority.	Rs.10,000 for each default	Rs. 10,000 for each default
272A(1)(b)	Refuses to sign any statement made by a person in course of I.T. Proceeding.	Rs.10,000 for each default	Rs. 10,000 for each default
272A(1)(c)	Failure to comply with summons issued u/s.131(1)	Rs.10,000 for each default	Rs. 10,000 for each default
272AA	Failure to comply with provisions of Sec. 133B.	Any amount upto	Rs. 1000
272B	Failure to comply with the provisions of section 139A or for quoting or intimating a PAN which is false. [w.e.f. 1.6.2002]	Rs. 10,000	Rs. 10,000
272BB	Failure to comply with the provisions of section 203A (i.e. failure to obtain TAN or after obtaining failure to quote TAN in all challans, certificates and returns etc.)	Rs. 10,000	Rs. 10,000
272BBB	Failure to comply with the provisions of of sec. 206CA (i.e. failure to obtain TCAN or after obtaining failure to quote TCAN in all challans, certificates and returns etc.) (w.e.f. 1.6.2002)	Rs. 10,000	Rs. 10,000

276BB	Failure to pay to the credit of Central Government tax collected u/s. 206	3 months and fine	7 years and fine
276C(1)	Wilful attempt to evade tax penalty or interest imposable under the Act (non-cognizable as per sec. 279A)	If tax evaded exceeds Rs. 1,000, 6 months; otherwise 3 months and fine.	If tax evaded exceeds Rs. 1,00,000, 7 years; otherwise 3 years and fine.
276C(2)	Wilful attempt to evade the payment of any tax, penalty or interest (non-cognizable as per sec. 279A).	3 months and fine	3 years and fine
276CC	Wilful failure to file return of income in time u/s. 139(1), or in response to notice u/s. 142(1) or sec. 148(Non-cognizable as per sec. 279A)	If tax evaded exceeds Rs. 1,00,000; 6 months and fine In any other case, 3 months and fine. ***Note:*** No prosecution if : (i) the return is filed before the expiry of the assessment year ; or (ii) the tax payable on regular assessment, as reduced by TDS and advance tax does not exceed Rs. 3,000	If tax evaded exceeds Rs. 1,00,000, 7 years; otherwise 3 years and fine

276CCC	Wilful failure to furnish in due time the return of total income which is required to be furnished u/s. 158BC.	3 months and fine	3 months and fine
276D	Wilful failure to produce books of account and documents u/s. 142(1) or wilful failure to comply with a direction to get the accounts audited u/s. 142(2A)	Any period upto 1 year and fine of Rs. 4 for every day during which default continues.	1 year and fine of Rs. 10 every day during which default continues.
277..	Making a false statement in verification or delivering a false account or statement(non-cognizable as per sec.279A)	If tax evaded exceeds Rs. 1,00,000; 6 months; otherwise 3 months and fine.	If tax evaded exceedsRs. 1,00,000, 7 years; otherwise 3 years and fine.
278..	Abetment to make a false statement or declaration. (non- cognizable as per,sec. 279A)	If tax evaded exceeds Rs. 1,00,000; 6 months; otherwise 3 months and fine.	If tax evaded exceedsRs. 1,00,000, 7 years; otherwise 3 years and fine.
278A	Punishment for second and subsequent offences u/ss. 276B, 276C(1), 276CC, 277 or 278.	6 months for every offence	7 years for every offence
278B and 278C	Offences committed by companies/firms or HUFs-Criminal liability of managing director managing partner, karta or any such officer, who wilfully committed the offence for the company/firm or HUF.	Same as in the case of the company/firm/ HUF	Same as in the case of the company/firm/ HUF
280(1)	Disclosure of particulars by public servants in contravention of sec. 138(2) (prosecution to be instituted	6 months and fine.	6 months and fine.

280(1)	servants in contravention of sec. 138(2) (prosecution to be instituted with the approval of Central Government)	6 months and fine.	6 months and fine.

If there is a reasonable cause, it can bf offered as a defense against penalty, prosecution, etc.

Reasonable cause can be reasonably said to be a cause which prevents a man of average intelligence and ordinary prudence, acting under normal circumstances, without negligence or inaction or want of *bona fides* - *Azadi Bachao Andolan* v. *Union of India* 252 ITR 471 (Delhi).

'Reasonable cause' as applied to human action is that which would constrain a person of average intelligence and ordinary prudence. It means an honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which, assuming them to be true, would reasonably lead any ordinary prudent and cautious man, placed in the position of the person concerned, to come to the conclusion that the same was the right thing to do - *Woodward Governors India (P.) Ltd.* v. *CIT* 118 Taxman 433 (Delhi).

The words "reasonable cause" in the section must necessarily have a relation to the failure on the part of the assessee to comply with the requirement of the law which he had failed to comply with. *Kalakrithi* v. *ITO* 125 Taxman 97 (Mad.).

Liability of directors of private company in liquidation.

Under certain circumstances directors of private company in liquidation are liable to tax liability of the company. Care should be taken to ensure that directors are not exposed to this risk.

Section 179 provides that where any tax due from a private company in respect of any income of any previous year or from any public company of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of the private company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax.

No recovery can be made from a director if the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Section 179 operates without regard to any contrary provision about limited liability, etc. contained in the Companies Act, 1956.

FRINGE BENEFIT TAX

Background:

The rationale for levying a fringe benefit tax on the employer lies in the inherent difficulty in isolating the 'personal element' where there is collective enjoyment of benefits and attributing the same directly to the employee. This is so especially where the expenditure incurred by the employer is ostensibly for purposes of the business but includes, in partial measure, a benefit of a personal nature. Moreover, in cases where the employer directly reimburses the employee for expenses incurred, it becomes difficult to effectively capture the true extent of the perquisite provided because of the problem of cash flow in the hands of the employer.

Planning for FBT can be as follows:

1. FBT is not applicable to individual and HUF therefore small business should be run as individual or HUF instead of partnership firms or small companies.

2. In case of small companies and partnership firms if number of employees is less and if the work is outsourced and there are no employees, as such FBT will not be applicable.

3. In case of charitable or religious trust registration under section 12AA should be obtained which will avoid liability of FBT.

4. Instead of giving perquisites possibility of substituting them by allowances should be considered.

5. No FBT is payable on (i) expenditure on food or beverages provided by the employer to his employees in office or factory; however, reimbursement to employee for this purpose is not exempt from FBT and (ii) expenditure on paid vouchers which are not transferable and usable only at eating joints or outlets. Possibility of exploring these perquisites should be considered.

6. Incase company has network of distributors expenditure on traveling, conveyance should be incurred by such distributors and reimbursement should be made by the company, if it is a distributor or proprietory concern then they too are not liable for FBT.

7. Proper bifurcation of traveling and conveyance should be maintained since 5% of the traveling is concerned as FBT and 20% of conveyance expense is concerned as FBT.

8. Out of employees' welfare expenses , separate account should be maintained for (i) expenditure incurred to fulfill any statutory obligation (ii) mitigate occupational hazards (iii) provide first aid facilities in the hospital or dispensary run by the employer, as no FBT is applicable for such expenses.

9. Incase conference expenses are incurred amount of participation should be separately amounted as no FBT is payable on such expenses.

PROVISIONS FOR FILING RETURN OF INCOME

RETURN OF INCOME

The Income-tax Act contains provisions for filing of return of income. Return of income is the format in which the assessee furnishes information as to his total income and tax payable. The format for filing of returns by different assessees is notified by the CBDT. The particulars of income earned under different heads, gross total income, deductions from gross total income, total income and tax payable by the assessee are generally required to be furnished in a return of income. In short, a return of income is the declaration of income by the assessee in the prescribed format.

COMPULSORY FILING OF RETURN OF INCOME [SECTION 139(1)]

(1) As per section 139(1), it is compulsory for companies and firms to file a return of income or loss for every previous year on or before the due date in the prescribed form.

(2) In case of a person other than a company or a firm, filing of return of income on or before the due date is mandatory, if his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeds the basic exemption limit.

(3) Such persons should, on or before the due date, furnish a return of his income or the income of such other person during the previous year in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed.

(4) Further, every person, being an individual or a HUF or an AOP or BOI or an artificial juridical person -

- whose total income or the total income of any other person in respect of which he is assessable under this Act during the previous year

- without giving effect to the provisions of section 10A or 10B or 10BA or Chapter VI-A

- exceeded the basic exemption limit is required to file a return of his income or income of such other person on or before the due date in the prescribed form and manner and setting forth the prescribed particulars.

(5) 'Due date' means -

(a) 31st September of the assessment year, where the assessee is -

(i) a company; or

(ii) a person (other than a company) whose accounts are required to be audited under the Income-tax Act, 1961 or any other law in force; or

(iii) a working partner of a firm whose accounts are required to be audited under the Income-tax Act, 1961 or any other law for the time being in force.

(b) 31st July of the assessment year, in the case of any other assessee.

OPTION TO FURNISH RETURN OF INCOME TO EMPLOYER [SECTION 139(1A)]

(1) This section gives an option to a person, being an individual who is in receipt of income chargeable under the head "Salaries", to furnish a return of his income for any previous year to his employer, in accordance with such scheme as may be notified by the CBDT and subject to such conditions as may be specified therein.

(2) Such employer shall furnish all returns of income received by him on or before the due date, in such form (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media) and manner as may be specified in that scheme.

(3) In such a case, any employee who has filed a return of his income to his employer shall be deemed to have furnished a return of income under sub-section (1).

INCOME-TAX RETURN THROUGH COMPUTER READABLE MEDIA [SECTION 139(1B)]

(1) This sub-section enables the taxpayer to file his return of income in computer readable media, without interface with the department.

(2) Such person may, on or before the due date, furnish a return of income in accordance with such scheme as may be notified by the CBDT, in such form (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media) and manner as may be specified in that scheme.

Accordingly all companies are required to file the return of income and also of FBT in electronic form. Further, certain other entities who's accounts are subject to tax audit must file the return of income and also of FBT in electronic form.

RETURN OF LOSS [SECTION 139(3)]

(1) This section requires the assessee to file a return of loss in the same manner as in the case of return of income within the time allowed under section 139(1).

(2) Under section 80, an assessee cannot carry forward or set off his loss against income in the same or subsequent year unless he has filed a return of loss in accordance with the provisions of section 139(3).

(3) A return of loss has to be filed by the assessee in his own interest and the nonreceipt of a notice from the Assessing Officer requiring him to file the return cannot be a valid excuse under any circumstances for the non-filing of such return.

(4) In particular, a return of loss must be filed by an assessee who has incurred a loss under the heads "profits and gains from business or profession", "capital gains", and income

from the activity of owning and maintaining race horses taxable under the head "Income from other sources".

(5) However, loss under the head "Income from house property" under section 71B and unabsorbed depreciation under section 32 can be carried forward for set-off even though return of loss has not been filed before the due date.

BELATED RETURN [SECTION 139(4)]

(1) Any person who has not furnished a return within the time allowed to him under section 139(1) or within the time allowed under a notice issued under section 142(1) may furnish the return for any previous year at any time -

(i) before the expiry of one year from the end of the relevant assessment year; or

(ii) before the completion of the assessment,

whichever is earlier.

RETURN OF INCOME OF CHARITABLE TRUSTS AND INSTITUTIONS [SECTION 139(4A)]

(1) Every person in receipt of income -

(i) derived from property held under a trust or any other legal obligation wholly or partly for charitable or religious purpose; or

(ii) by way of voluntary contributions on behalf of such trust or institution must furnish a return of income if the total income in respect of which he is assessable as a representative assessee (computed before allowing any exemption under sections 11 and 12) exceeds the basic exemption limit.

(2) Such persons should furnish the return in the prescribed form and verified in the prescribed manner containing all the particulars prescribed for this purpose.

(3) This return must be filed by the representative-assessee voluntarily within the time limit. Any failure on the part of the assessee would attract liability to pay interest and penalty.

RETURN OF INCOME OF POLITICAL PARTIES [SECTION 139(4B)]

(1) Under this section, a political party is required to file a return of income if, before claiming exemption under section 13A, the party has taxable income.

(2) The grant of exemption from income-tax to any political party under section 13A is subject to the condition that the political party submits a return of its total income within the time limit prescribed under section 139(1).

(3) The chief executive officer of the political party is statutorily required to furnish a return of income of the party for the relevant assessment year, if the amount of total income of

the previous year exceeds the basic exemption limit before claiming exemption under section 13A.

REVISED RETURN [SECTION 139(5)]

(1) If any person having furnished a return under section 139(1) or in pursuance of a notice issued under section 142(1), discovers any omission or any wrong statement therein, he may furnish a revised return at any time before the expiry of one year from the end of the relevant assessment year or before completion of assessment, whichever is earlier.

(2) It may be noted that a belated return cannot be revised. It has been held in Kumar Jagdish Chandra Sinha v. CIT [1996] 86 Taxman 122 (SC) that only a return furnished under section 139(1) or in pursuance of a notice under section 142(1) can be revised. A belated return furnished under section 139(4), therefore, cannot be revised.

PARTICULARS REQUIRED TO BE FURNISHED WITH THE RETURN [SECTION 139(6)]

The prescribed form of the return shall, in certain specified cases, require the assessee to

furnish the particulars of -

(i) income exempt from tax
(ii) assets of the prescribed nature and value and belonging to him
(iii) his bank account and credit card held by him
(iv) expenditure exceeding the prescribed limits incurred by him under prescribed heads
(v) such other outgoings as may be prescribed.

DEFECTIVE RETURN [SECTION 139(9)]

(1) Under this sub-section, the Assessing Officer has the power to call upon the assessee to rectify a defective return.

(2) Where the Assessing Officer considers that the return of income furnished by the assessee is defective, he may intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation. The Assessing Officer has the discretion to extend the time period beyond 15 days, on an application made by the assessee.

(3) If the defect is not rectified within the period of 15 days or such further extended period, then the return would be treated as an invalid return. The consequential effect would be the same as if the assessee had failed to furnish the return.

(4) Where, however, the assessee rectifies the defect after the expiry of the period of 15 days or the further extended period, but before assessment is made, the Assessing Officer can condone the delay and treat the return as a valid return.

PERMANENT ACCOUNT NUMBER (PAN) [SECTION 139A]

(1) Where the following persons have not been allotted a permanent account number (PAN), they should apply to the Assessing Officer within the prescribed time for the allotment of a PAN -

(i) Every person whose total income or the total income of any other person in respect of which he is assessable under this Act during any previous year exceeded the basic exemption limit; or

(ii) Every person carrying on any business or profession whose total sales, turnover or gross receipts exceeds or is likely to exceed Rs.5 lakhs in any previous year; or

(iii) Every person who is required to furnish a return of income under section 139(4A); or

(iv) Every person, being an employer, who is required to furnish a return of fringe benefits under section 115WD [Sub-section (1)].

(2) The CBDT had introduced a new scheme of allotment of computerized 10 digit PAN. Such PAN comprises of 10 alphanumeric characters and is issued in the form of a laminated card.

(3) All persons who were allotted PAN (Old PAN) earlier and all those persons who were not so allotted but were required to apply for PAN, shall apply to the Assessing Officer for a new series PAN within specified time.

(4) Once the new series PAN is allotted to any person, the old PAN shall cease to have effect. No person who has obtained the new series PAN shall apply, obtain or process another PAN.

SCHEME FOR SUBMISSION OF RETURNS THROUGH TAX RETURN PREPARERS [SECTION 139B]

(1) The Tax Return Preparer shall assist the persons furnishing the return in a manner that will be specified in the Scheme, and shall also affix his signature on such return. The "specified class or classes of persons" for this purpose means any person other than a company or a person whose accounts are required to be audited under section 44AB (tax audit) or under any other existing law, who is required to furnish a return of income under the Act.

(2) A Tax Return Preparer can be an individual, other than

(i) any officer of a scheduled bank with which the assessee maintains a current account or has other regular dealings.

(ii) any legal practitioner who is entitled to practice in any civil court in India.

(iii) a chartered accountant.

(iv) an employee of the 'specified class or classes of persons'.

(3) The Scheme notified under the said section may provide for the following -

(i) the manner in which and the period for which the Tax Return Preparers shall be authorised,

(ii) the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax Return Preparer,

(iii) the code of conduct for the Tax Return Preparers,

(iv) the duties and obligations of the Tax Return Preparers,

(v) the circumstances under which the authorisation given to a Tax Return Preparer may be withdrawn, and

(vi) any other relevant matter as may be specified by the Scheme.

Grievances Redressal Procedure

When the assessment order is passed against the assessee, and if he is not satisfied with any order passed by the assessing officer, he may appeal to higher court. Procedure for appeal is laid down under the act.

The redressal procedure under the act includes the following:

1. Rectification
2. Appeal
3. Revision

1. Rectification:

Sec. 154 : Rectification of mistake.

With a view to rectifying any mistake apparent from the record an income-tax authority referred to in section 116 may, —

(a) amend any order passed by it under the provisions of this Act;

(b) amend any intimation or deemed intimation under sub-section (1) of section 143.

Where any matter has been considered and decided in any proceeding by way of appeal or revision relating to an order, the authority passing such order may, notwithstanding anything contained in any law for the time being in force, amend the order under that sub-section in relation to any matter other than the matter which has been so considered and decided.

Subject to the other provisions of this section, the authority concerned-

(a) may make an amendment of its own motion, and

(b) shall make such amendment for rectifying any such mistake which has been brought to its notice by the assessee, and where the authority concerned is the Commissioner (Appeals), by the Assessing Officer also.

An amendment, which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee, shall not be made under this section unless the authority concerned has given notice to the assessee of its intention so to do and has allowed the assessee a reasonable opportunity of being heard.

No amendment under this section can be made after the expiry of 4 years from the end of the financial year in which the order sought to be amended was passed. It may be noted that an amendment is made when the related order is passed. This period of limitation is not applicable in case the provisions of section 155 are applicable. Extension of time limit under certain circumstances is specified under section 155.

However, if a valid application has been made by the assessee for rectification within the statutory time limit but is not disposed of by the concerned authority within the time specified, it may be disposed of even after the expiry of such time limit [Circular No. 73, dated 7th January, 1972]. This relief is, however, not admissible in case rectification proceedings are initiated by the department itself.

APPEAL AND APPELLATE HIERARCHY

Appeal is a complaint to a higher court relating to an injustice done by a lower court. The party complaining is called "appellant" and the other party is known as "respondent". There are various provisions in the Income-tax Act relating to appeals and revision of orders.

Under the Income-tax Act, the following remedial measures are available to the assessees if he is not satisfy with any order passed by the assessing officer :-

i) **Appeal** The first shall lie with the Commissioner of Income Tax (Appeals) against the order of the assessing officer (sec. 246A), or

ii) **Revision** if appeal is not preferred or it could not be filed within the time limit allowed, the assessee can apply u/s. 264 to the Commissioner of Income Tax for revision of orders passed by the assessing officer.

The Commissioner of Income-tax can also take up suo moto the case for revision. Where, however, in the opinion of the Commissioner of Income Tax the order passed by the assessing officer is erroneous and prejudicial to the interest of revenue, the Commissioner of Income Tax can also take up the case for revision u/s. 263.

Appeal to Commissioner of Income Tax (Appeals) [Sec. 246A]

An aggrieved assessee may appeal to the Commissioner of Income Tax (Appeals) against the following orders of Assessing officer. However, the order should be under section that is specified under section 246A e.g. 143(3), 144, 147, 150, 221, 271, 271A, 271B, 271F, 272BB, etc.

Denial of liability to tax under particular circumstances is also covered - The expression 'denial of liability' is comprehensive enough to take in not only the total denial of liability but also the liability to tax under particular circumstances. Thus, an assessee has a right of appeal against the order of the ITO assessing the AOP instead of the members thereof individually - *CIT* v. *Kanpur Coal Syndicate* 53 ITR 225

Procedure for filing appeal is prescribed. Fees are also required to be paid before filing of the appeal. [Sec. 249 & Rules 45 & 46]

Powers of the [Commissioner (Appeals)].[Sec .251.]

(1) In disposing of an appeal, the [Commissioner (Appeals)] shall have the following powers—

(*a*) in an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment

(*b*) in an appeal against an order imposing a penalty, he may confirm or cancel such order or vary it so as either to enhance or to reduce the penalty;

(*c*) in any other case, he may pass such orders in the appeal as he thinks fit.

(2) The [Commissioner (Appeals)] shall not enhance an assessment or a penalty or reduce the amount of refund unless the appellant has had a reasonable opportunity of showing cause against such enhancement or reduction.

Explanation.—In disposing of an appeal, the [Commissioner (Appeals)] may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, notwithstanding that such matter was not raised before the [Commissioner (Appeals)] by the appellant.

Appeal to the Appellate Tribunal [Sec. 253]

The Appellate Tribunal is constituted by the Central Government and has two classes of members – judicial and accountant.

An assessee may file an appeal before the Appellate Tribunal against the following orders u / s. 253, etc.

The Commissioner may also, if he objects to any order passed by the Commissioner (Appeals) u / s. 154 / 250, direct the assessing officer to appeal to the Appellate Tribunal against the order [Sec. 253(2)].

It may be mentioned that the Appellate Tribunal is the fact finding authority and hence the order passed by it on questions of fact are final and conclusive.

he Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit.

Procedure of Appellate Tribunal [Sec. 255]

(1) The powers and functions of the Appellate Tribunal may be exercised and discharged by Benches constituted by the President of the Appellate Tribunal from among the members thereof.

(2) Subject to the provisions contained in sub-section (3), a Bench shall consist of one judicial member and one accountant member.

(3) The President or any other member of the Appellate Tribunal authorised in this behalf by the Central Government may, sitting singly, dispose of any case which has been allotted to the Bench of which he is a member and which pertains to an assessee whose total income as computed by the [Assessing] Officer in the case does not exceed [five hundred thousand rupees], and the President may, for the disposal of any particular case, constitute a Special Bench consisting of three or more members, one of whom shall necessarily be a judicial member and one an accountant member.

(4) If the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority, if there is a majority, but if the members are equally divided, they shall state the point or points on which they differ, and the case shall be referred by the President of the Appellate Tribunal for hearing on such point or points by one or more of the other members of the Appellate Tribunal, and such point or points shall be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case, including those who first heard it.

(5) Subject to the provisions of this Act, the Appellate Tribunal shall have power to regulate its own procedure and the procedure of Benches thereof in all matters arising out of the exercise of its powers or of the discharge of its functions, including the places at which the Benches shall hold their sittings.

(6) The Appellate Tribunal shall, for the purpose of discharging its functions, have all the powers which are vested in the income-tax authorities referred to in section 131, and any proceeding before the Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228 and for the purpose of section 196 of the Indian Penal Code (45 of 1860), and the Appellate Tribunal shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXXV of the Code of Criminal Procedure, 1898 (5 of 1898).

Appeal to the High Court [Sec 260A & 260B]

An appeal shall lie to the High Court from every appellate order passed by the tribunal, if the High Court is satisfied that the case involves a substantial question of law. The appeal may be filed by the Commissioner or the assessee. The Memorandum of Appeal shall precisely state the substantial question of law involving the appeal. An appeal along with a fee (as per Court Fees Act), shall be filed within 120 days of the date of receipt of the order appealed against. The question of law shall be formulated by the High Court, then the appeal shall be heard by a bench of at least two judges and decided by majority opinion. [Secs. 260A and 260B]

Appeal to the Supreme Court [Sec. 261]

An appeal lies before the Supreme Court, against an order of the High Court in a reference, or in an appeal. Such appeal can be filed only if the High Court certifies it to be a fit case for appeal to the Supreme Court. If the High Court refuses to grant such a certificate, the assessee can file a Special Leave Petition before the Supreme Court. If the SLP is granted, the Supreme Court will hear and decide the appeal on merits. [Sec. 261]

Revision

Provisions relating to powers of revision of the Commissioner of Income Tax provides in sections 263 and 264 of the Income-tax Act which are analysed in a tubular form as under :

Section 263	Section 264
I. Scope:	
1 Revision of order erroneous and prejudicial to the interest of revenue passed by the Assessing officer	Revision of other orders by any subordinate authority.
2 Two circumstances must exist to enable the Commissioner to exercise the power of revision viz. (i) the order should be erroneous; and (ii) by virtue of the order being erroneous prejudice must have been caused to the interest of the Revenue. CIT-vs.- Gabriel India Ltd., 203 ITR 108(Bom).	The Commissioner shall not revise any order where the appeal against the order is pending before the first or second appellate authorities (or) where the time for filing the appeal has not lapsed and the assessee has not waived his right of appeal.
II. Procedure :	
3 Commissioner of Income Tax may call for and examine the records and revise the orders after hearing the assessee.	Commissioner of Income-tax either on his own motion or on an application by the assessee can call for the records and revise the order.
4 Record shall include all records relating to any proceeding available at the time of examination of the file by the Commissioner of Income-tax.	Every application for revision should be accompanied by a fee Rs. 500.
III. Nature of order :	
5 An order enhancing, modifying or cancelling the assessment can be passed by the Commissioner.	An order which is not prejudicial to the interest of the assessee can be passed.
6 If the Income-tax Officer makes any mistake in carrying out the directions of the Appellate Assistant Commissioner or the Tribunal, his order can berevised by the Commissioner of Income Tax. Warner Lambert Co.-vs.- CIT, 205 ITR 395(Bom).	Commissioner declining to interfere will not amount to passing of an order prejudicial to the assessee.

7	The Commissioner of Income Tax has jurisdiction and powers to initiate proceedings in respect of issues not touched by the CIT(Appeals) in his Appellate Order- CIT-vs.-Jayakumar B. Patil, 236 ITR 469(SC).	Where depreciation was not claimed before the Income-tax Officer or the Appellate Assistant Commissioner but was claimed for the first time before the Commissioner of Income Tax in an application u/s. 264, the Commissioner must allow the claim on merits. Rashtriya Vikas Ltd. vs. CIT,196 ITR694(All.)
IV. Time limit :		
8	No order can be passed after the expiry of 2 years from the end of the Financial Year in which the order to be revised was passed.	a) Commissioner cannot revise any order beyond 1 year period, b) Assessee cannot file an application after expiry of 1 year from the date of service of the order. Condonation of delay is possible if sufficient cause is shown.
9	An order in revision may be passed at any time in the case of an order which has been passed in consequence of or to give effect to any finding or direction contained in an order of the Appellate Tribunal, the High Court or the supreme court.	Commissioner should pass an order disposing of the revision petition within one year from the end of the Financial Year in which the revision petition was filed by the assessee.
V. Remedy :		
10	Appeal can be filed to the Appellate Tribunal.	There is no right of appeal.

Special Economic Zones

In respect of tax planning, SEZ now provides substantial relief from tax for business undertakings. It is, therefore, necessary to understand provisions relating to SEZ. The provisions for tax exemption are contained in section 10AA of the Income tax Act, 1961.

Salient features of provisions for exemption are as under:

1. Any entrepreneur as referred to section 2 of the Special Economic Zones Act, 2005, from his Unit, who begins to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after the 1st day of April, 2006, a deduction of profits and gains derived from the export, of such articles or things or from services, as the case may be:

   (i) for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services - hundred per cent

   (ii) for further five assessment years - fifty per cent and thereafter;

   (i*ii*) for the next five consecutive assessment years - so much of the amount not exceeding fifty per cent of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account, called the "Special Economic Zone Re-investment Reserve Account" to be created and utilized for the purposes of the business of the assessee.

2. The amount credited to reserve account, called the "Special Economic Zone Re-investment Reserve Account" must comply with the following conditions:

(*a*) the amount credited to the Special Economic Zone Re-investment Reserve Account is to be utilised—

(*i*) for the purposes of acquiring machinery or plant which is first put to use before the expiry of a period of three years following the previous year in which the reserve was created; and

(*ii*) until the acquisition of the machinery or plant as aforesaid, for the purposes of the business of the undertaking other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India;

(*b*) the particulars, as may be specified by the CBDT in this behalf, have been furnished by the assessee in respect of machinery or plant along with the return of income for the assessment year relevant to the previous year in which such plant or machinery was first put to use.

Where any amount credited to the Special Economic Zone Re-investment Reserve Account—

(*a*) has been utilised for any purpose other than those specified, the amount so utilised; or

(*b*) has not been utilised before the expiry of the period specified, the amount not so utilised, shall be deemed to be the profits,—

(*i*) in a case referred to in clause (*a*), in the year in which the amount was so utilised; or

(*ii*) in a case referred to in clause (*b*), in the year immediately following the period of three years specified and shall be charged to tax accordingly.

3. Te exemption u/s 10AA applies to any undertaking, being the Unit, which fulfils all the following conditions, namely:—

(i) it has begun or begins to manufacture or produce articles or things or provide services during the previous year relevant to the assessment year commencing on or after the 1st day of April, 2006 in any Special Economic Zone;

(ii) it is not formed by the splitting up, or the reconstruction, of a business already in existence (however, this condition shall not apply in respect of any undertaking, being the Unit, which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;

(iii) it is not formed by the transfer to a new business, of machinery or plant previously used for any purpose.

4. Where any undertaking being the Unit which is entitled to the deduction under this section 10AA is transferred, before the expiry of the period specified in this section, to another undertaking, being the Unit in a scheme of amalgamation or demerger,—

   (*a*) no deduction shall be admissible under this section to the amalgamating or the demerged Unit, being the company for the previous year in which the amalgamation or the demerger takes place; and

   (*b*) the provisions of this section shall, as they would have applied to the amalgamating or the demerged Unit being the company as if the amalgamation or demerger had not taken place.

5. Loss referred to in sub-section (1) of section 72 or sub-section (1) or sub-section (3) of section 74, in so far as such loss relates to the business of the undertaking, being the Unit shall be allowed to be carried forward or set off.

6. For the purposes of exemption working, the profits derived from the export of articles or things or services shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of such articles or things or services bears to the total turnover of the business carried on by the assessee.

7. For the purposes of this section,—

   (*i*) "export turnover" means the consideration in respect of export by the undertaking, being the Unit of articles or things or services received in, or brought into, India by the assessee but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things outside India or expenses, if any, incurred in foreign exchange in rendering of services, computer software outside India;

   (*ii*) "export in relation to the Special Economic Zones" means taking goods or providing services out of India from a Special Economic Zone by land, sea, air, or by any other mode, whether physical or otherwise;

   (*iii*) "manufacture" shall have the same meaning as assigned to it in section 2 of the Special Economic Zones Act, 2005

   (*iv*) "relevant assessment year" means any assessment year falling within a period of fifteen consecutive assessment years referred to in this section;

   (*v*) "Special Economic Zone" and "Unit" shall have the same meanings as assigned to them under clauses (*za*) and (*zc*) of section 2 of the Special Economic Zones Act, 2005.

Tax Credit for tax paid on 'Book Profits'.

Under section 15JB in the case of a company, the income-tax, payable on the total income as computed under this Act in respect of any assessment year, is less than ten per cent of its 'book profit', such book profit is deemed to be the total income of the company and the tax is payable by the company on such 'book profit' shall be the amount of income-tax at the rate of ten per cent.

Tax credit in respect of tax paid on deemed income relating to certain companies.

Section 115JAA provides that when any tax is paid under section 115JB by any company for the assessment year commencing on the 1st day of April, 2006 and any subsequent assessment year, then, credit in respect of tax so paid shall be allowed to him in accordance with the provisions of this section.

The tax credit to be allowed is the difference of the tax paid for any assessment year under section 115JB and the amount of tax payable by the assessee on his total income computed in accordance with the other provisions of this Act.

The tax credit shall be allowed set-off in a year when tax becomes payable on the total income computed in accordance with the provisions of this Act other than on 'book profits'.

Set off in respect of brought forward tax credit shall be allowed for any assessment year to the extent of the difference between the tax on his total income and the tax which would have been payable under the provisions of section 115 JB.

The amount of tax credit determined under section 115JAA can not be carried forward and set off beyond the seventh assessment year immediately succeeding the assessment year in which tax credit becomes allowable under section.

However, no interest shall be payable on the tax credit allowed under section 115 JAA.

When any company becomes liable for payment of tax on book profits', it should be ensured that an amount of tax credit should be ascertained and credit should be availed in terms of these provisions.

TAX ADMINISTRATION

INCOME TAX AUTHORITIES [SEC. 116]

In order to discharge executive and administrative functions relating to the Act, the following income-tax authorities have been constituted –

a) The Central Board of Direct Taxes;

b) Directors General of Income-tax or Chief Commissioners of Income-tax;

c) Directors of Income-tax or Commissioners of Income-tax or Commissioners of I come-tax (Appeals);

d) Additional Directors of Income-tax or Additional Commissioners of Income-tax or Additional Commissioners of Income-tax (Appeals);

e) Joint Directors of Income-tax or Joint Commissioners of Income-tax;

f) Deputy Director of Income-tax or Deputy Commissioner of Income-tax or Deputy Commissioner of Income-tax (Appeals);

g) Assistant Directors of Income-tax or Assistant Commissioners of Income-tax;

h) Income-tax Officers;

i) Tax Recovery Officers;

j) Inspectors of Income-tax.

CENTRAL BOARD OF DIRECT TAXES

The Central Board of Direct Taxes (CBDT) has been constituted under the Central Board of Revenue Act, 1963. It functions under the Ministry of Finance. The important powers of CBDT are:

i) To make rules for carrying out purposes of the Act [Sec. 295].

ii) To decide jurisdiction of the Income-tax Authorities [Sec. 120].

iii) To issue instructions, orders and directions to other Income-tax authorities for proper administration of this Act and all other persons employed in the execution of this Act. However, it cannot issue instructions to the Commissioner of Income-tax (Appeals). It cannot issue a direction to any Income-tax authority to dispose of a case in a particular manner. [Sec. 119],

iv) To declare an organization as company [Sec. 2(17) (iv)].

v) To entertain objections in respect of search and seizure under the Act. [Sec.132].

vi) To relax the provisions of Sections 139, 143, 144, 147, 148, 154, 155, 158BFA, 201(1A), 210, 211, 234A, 234B, 234C, 271 and 273 or otherwise [Section 119(2)(a)].

vii) Power of relaxing any requirement contained in Chapter IV (provisions for computation of income under various heads) or Chapter VI-A (provisions for deductions from gross total income) [Section 119(2)(c)].

viii) Issue such general or special orders for relaxation of the provisions of sections relating to FBT viz; 115WD, 115WE, 115WF, 115WG, 115WH, 115WJ and 115WK [Section 119(2)(a)].

ix) Prescribe categories of transactions and documents pertaining to business or profession, where quoting of PAN is necessary [Sec, 139A].

x) Frame a scheme in respect of 'Tax Return Preparers' [Sec. 139B].

xi) Prescribe class of persons by whom return of income [Sec. 139D] and TDS statements [Sec. 200] should be filed electronically.

xii) Prescribing qualifications for Authorized Representatives [Sec. 288].

xiii) Condone delay for seeking CBDT's approval, where it is required [Sec. 293B] and authorize any income tax authority not being Commissioner of Income-tax (Appeals), to admit belatedly ant claim for exemption, deduction, refund or relief [Section 119(2)(b)].

xiv) To prescribe method for computation of arm's length price [Section 92C].and to prescribe record to be kept and the time for which it is to be preserved [Section 92D].

Circulars issued by the CBDT are legally binding on the revenue and this binding character attaches to the circulars even if they are found not in accordance with the correct interpretation of a statutory provision and they depart or deviate from such construction - *K.P. Varghese* v. *ITO* 131 ITR 597 (SC).

It is well-settled that circulars can bind the ITO but will not bind the appellate authority or the Tribunal or the Court or even the assessee - *CIT* v. *Hero Cycles (P.) Ltd.* 228 ITR 463 (SC).

CBDT has power, interalia, to tone down the rigor of the laws and ensure fair enforcement of its provision by issuing circular.

Circular contemplated in sec.119 (2)(a) cannot be adverse to the assessee. Power is given for the purpose of just, proper and efficient management of work of assessment. Circular, however are not meant for contradicting or nullifying any provision of the statue. They are meant to mitigate the rigor of application of a particular provision. So long as such a circular is in favour, it would be binding on the departmental authorities in view of the provision of sec. 119 to ensure a uniform and proper administration & application of the IT Act - UCO Bank V CIT 237 ITR 899 (SC).

DIRECTOR GENERAL/DIRECTOR

The Central Government has power to appoint Director General and Director [Sec. 117]. The CBDT authorize them to perform such functions as may be assigned to them by [Sec. 120]. The powers enjoyed by them include:

i) To appoint an Income-tax authority below the rank of Assistant Commissioner / Deputy Commissioner, if authorised by the Board [Sec. 117].

ii) To direct the Joint Commissioner to function and assume the powers of assessing officer, if so authorised by the Board [Sec. 120].

iii) To transfer cases from one or more assessing officers to any other assessing officer who is subordinate to him [Sec. 127].

iv) To enquire or investigate concealed income of any person within his jurisdiction [Sec. 131(1A)].

v) Authorise any Joint Director / Joint Commissioner, Deputy Director / Deputy Commissioner, Assistant Director / Assistant Commissioner or Assessing Officer to enter, search and seize valuables [Sec. 132(1)].

vi) To requisition books of accounts, etc.[Sec. 132A].

vii) To survey [Sec. 133A].

viii) To make an enquiry [Sec. 135].

ix) To collect certain information [Sec. 133B]

COMMISSIONERS OF INCOME TAX / CHIEF COMMISSIONERS OF INCOME TAX

The Central Government has power to appoint Director General and Director [Sec. 117]. The CBDT authorize them to perform such functions as may be assigned to them by [Sec. 120]. The powers enjoyed by them include:

i) To appoint an Income–tax authority below the rank of Assistant Commissioner / Deputy Commissioner, if authorised by the Board – [Sec. 117].

ii) To direct the Joint Commissioner to function and assume the powers of assessing officer, if so authorised by the Board – [Sec. 120].

iii) To transfer cases from one or more assessing officers to any other assessing officer who is subordinate to him – [Sec. 127].

iv) To enquire or investigate conceal income of any person within his jurisdiction – [Sec. 131(1A)].

v) To authorise any Joint Director / Joint Commissioner, Deputy Director / Deputy Commissioner, Assistant Director / Assistant Commissioner or Assessing Officer to enter, search and seize valuables – [Sec. 132(1)].

vi) To requisition books of accounts, etc. – [Sec. 132A].

vii) To survey – [Sec. 133A].

viii) To make an enquiry – [Sec. 135].

ix) To collect certain information– [Sec. 133B]

Additional Powers

i) Power regarding discovery, production of evidence, etc. [Sec. 131].

ii) To sanction reopening of assessments after the expiry of four years. [Sec.151(1)].

iii) To direct the Assessing Officer to prefer appeal to the Tribunal against the order of First Appellate Authority. [Sec. 253(2)]

iv) Request the Tribunal to file Reference to High Court. [Sec. 256].

v) To revise any order passed by the Assessing Officer that is prejudicial to revenue. [Sec. 263].

vi) To revise any order passed by a subordinate authority on an application by the assessee or *suo moto* when the revision is in favour of the assessee .[Sec.264]

COMMISSIONER OF INCOME-TAX (APPEALS)

Appointment is made by the Central Government. The following are important powers:

i) Power regarding discovery, production of evidence etc. [sec. 131]

ii) To condone delay in filing of appeal.

iii) Power to call for information. [sec. 133]

iv) Power to inspect register of companies. [sec. 134]

v) To dispose of an appeal and to confirm, reduce, enhance or annul the assessment [sec. 251]

vi) Power to impose a penalty. [sec. 271]

vii) Power to set off any refund against arrears of tax. [sec. 245].

viii) The Commissioner (Appeals) has inherent powers to stay recovery proceedings *Paulsons Litho Works* v. *ITO* 208 ITR 676 (Mad.).

JOINT COMMISSIONER OF INCOME TAX

They are appointed by the Central Government. They enjoy the following powers :-

i) Power regarding discovery, production of evidence, etc. [sec. 131]

ii) Power of search and seizure, if authorised. [sec. 132]

iii) Power to call for information. [sec. 133]

iv) Power to survey- [Sec. 133A]

v) Power to make an enquiry- [Sec. 135]

vi) Power to collect certain information- [Sec. 133B]

vii) Power to inspect register of companies. [sec. 134]

viii) To sanction reopening of assessment after the expiry of 4 years, if the assess ment is made under any section other than sections 143(3) and 147.

ASSESSING OFFICER

'Assessing Officer' means the Assistant Commissioner or Deputy Commissioner or Assistant Director or Deputy Director or the Income-tax Officer who is vested with the relevant jurisdiction by virtue of directions or orders issued under Section 120 or any other provision of this Act, and the *Additional Commissioner or Additional Director or* Joint Commissioner or Joint Director who is directed under the said section 120 to exercise or perform all or any of the powers and functions conferred on, or assigned to, an Assessing Officer under this Act [sec. 2(7A)]

The following are some of the powers of Income-tax Officers —

i) Power regarding discovery, production of evidence, etc. [sec. 131]

ii) Power of search and seizure, if authorised. [sec. 132]

iii) Power to requisition books of accounts. [sec. 132A]

iv) To apply the assets seized and retained u/s. 132 in satisfaction of the existing liabilities of the assessee under Direct Taxes Act. [sec. 132B]

v) Power to call for information. [sec. 133]

vi) Power to collect certain information- [sec. 133B]

vii) Power to inspect register of companies. [sec. 134]

viii) Power to allot permanent account number. [sec. 139A]

ix) Power to direct an assessee to get his accounts audited. [sec. 142]

x) Power to make assessment. [sec. 143, 144]

xi) Power to reassess income which has escaped assessment.[sec. 147]

xii) Power to rectify mistakes apparent from the records, either on his own or on an application made by the assessee. [sec. 154]

xiii) Power to grant a certificate to an assessee to receive a payment without deduction of tax at source or deduction of tax at source at a lower rate than prescribed [secs. 194, 195, 197]

xiv) Power to impose penalty for default in payment of a tax. [sec. 221]

xv) Power to grant refund. [sec. 237, 240]

xvi) Power to withhold refund in certain cases [sec. 241]

xvii) Power to adjust the refund against any demand of tax etc. outstanding against the assessee. [sec. 245].

xviii) Power to impose penalty for the prescribed defaults under the Act [Chapter XXI]

xix) Power to initiate prosecution for the prescribed offences under the Act [Chapter XXII]

xx) Power to determine arm's length price of international transactions [Sec. 92C]

INSPECTORS OF INCOME TAX

Inspectors are appointed by the Commissioner of Income Tax.

They have to perform such functions as are assigned to them by the Commissioner or any other Income-tax authority under which they are appointed to perform their functions.

In case of survey, inspectors have power to inspect books of account and other documents, place marks of identification, to take statements at any function, ceremony or event [Sec. 133A].

Assessment of Various Entities

Assessment of Individuals

Tax incidence on Individuals

While computing taxable Income of an Individual following points should be considered

Nature of Income	Tax Treatment
Income earned by the taxpayer	Except the following all other incomes shall be included a. income exempt under sections 10 to 13A b. incomes to be included in income of others by virtue of section 60 to 64.
Share of Profit from Hindu undivided family	It is exempt under section 10(2)
Share of Profit from a firm assessed as firm	It is exempt under section 10(2A)
Salary and Interest from the aforesaid firm	These are taxable as business Income
Share of profit from an association of persons / body of Individuals	If the association / body is taxable at the maximum marginal rate(or at higher rate),then share of profit is not taxable in hands of recipient.
Income earned by others and included in the income of the taxpayer by virtue of section 60 to 64	Such income shall be included in the income of the taxpayer.

Special Provisions for persons governed by Portuguese Civil law (Section 5 A)

This Section is applicable for the appropriation of income between spouses governed by the Portuguese Civil Code which is in force in the state of Goa and Union territories of Dadra and Nagar Haveli and Daman and Diu. By virtue of this section, income from all other sources, except from salary, should be apportioned equally between husband and wife. The income so apportioned will be included separately in the total income of the husband and of the wife and the remaining provisions of act shall apply accordingly. Salary Income is, however, taxable in the hands of the spouse who has actually earned it.

Even the income from profession will be apportioned equally between the husband and the wife-

CIT v Datta V Gaitonde [2002] 241 ITR 241 / 108 / taxman 533(Bom).

Taxable income- How computed

Taxable income shall be computed as follows:

Step 1- Income under the different heads of income -First find out income under the five heads of income

Step 2- Adjustment of losses of the current year and earlier years- Losses should be setoff according to the provisions of sections 70 to 78. The income after adjustment of losses is the gross total income.

Step 3- Deduction from gross total income- Deductions specified under Chapter VI A should be considered while calculating the gross total income.

Step 4- Rounding off- The balance should be rounded off to the nearest Rs.10. it is called as net income or taxable income or total income.

Tax liability IS DECIDED BY THE APPLICABLE RATE STRUCTURE.

Special Provisions relating to non-residents [Section 115C to 115I]

The benefit of Special provisions can be claimed by non-resident Indians. The following are non-resident Indians for the purpose:

a. citizen of India who is a non-resident ;

b. a person of Indian origin who is a non-resident.

A person shall be deemed to be of Indian origin if he or either of his parents or any of his grandparents, was born in an undivided India.

The Provisions of Section 115C to 115I are applicable only in respect of the following incomes derived a non resident Indian:

a. investment income derived from a "foreign exchange assets"; and

b. long term capital gains on sale or transfer of "foreign exchange assets".

Foreign Exchange Asset- It means those "specified asset" which the assessee has acquired or purchased with, or subscribed to in, convertible foreign exchange;

The following are the "specified assets":

a. shares in an Indian Company (public or private)

b. debentures issued by an Indian Company which is not a private company ;

c. deposits with an Indian Company which is not a private Company, it may be even deposit with SBI or any other banking company;

d. any security of the Central Government ; and

e. such other asset as the Central Government may specify in this behalf by notification in the Official Gazette.

Investment Income

In computing the Investment income of a non-resident Indian, no deduction in respect of any expenditure or allowance shall be allowed under any provision of the Act. Moreover, no deduction under Sections 80C to 80U shall be allowed in respect of investment income of non – resident Indians.

Long term Capital gain

Long term Capital gain on sale or transfer of foreign exchange assets shall be calculated subject to:

1. The benefit of Indexation is not available for the sale or transfer of foreign exchange assets.

2. The non-resident Indian can claim exemption under section 115F by investing sale consideration in another asset.

3. No deduction is permissible under section 80C to 80U in respect of long term capital gain.

Tax treatment on Investment and long term capital Gain:

Non resident Indians are chargeable to tax on investment and long term capital gain at the rate of 20 percent and 10 percent respectively.(plus surcharge and education cess)

Return of Income not to be filled in certain cases:

Where a non-resident Indian has income only from a foreign exchange asset or income by way of long term capital gains arising on transfer of a foreign exchange asset, or both, and tax deductible at source from such income has been deducted, he is not required to file the return of income under section 139(1).

The income from foreign exchange assets and long term capital gains arising on transfer of such assets would be treated as separate block and charged to tax at a flat rate as explained above.

If the non-resident Indian has other Income in India, such other income is treated as an altogether separate block and charged to tax in accordance with other provisions of the Act.

Benefit available even after the assessee becomes resident – These provisions are as follows:

1. A non-resident Indian in any previous year, becomes assessable as resident in India in any subsequent year.

2. He may furnish to the Assessing Officer a declaration in writing(along with his return of income under section 139 for the assessment year for which he is so assessable)to the effect that the special provisions shall continue to apply to him in relation to the investment income derived from any foreign exchange asset.

3. The foreign exchange assets for this purpose are debentures and deposit with an Indian public limited company and Central Government securities.

The special provisions shall continue to apply for that assessment year and for every subsequent assessment year till the transfer or conversion (otherwise than by transfer) into money of such assets.

Special Provisions not to apply if the assessee so chooses (section 115-I)

A non Resident Indian may opt that the special provisions should not apply to him by making a declaration to that effect in his return of income for the relevant assessment year. In such case the whole of his Income (including income from foreign exchange assets and long term capital gains arising on transfer of a foreign exchange asset) is chargeable to tax under the general provisions of the Act.

ASSESSMENT OF HINDU UNDIVIDED FAMILY

U/s. 4 of the Income Tax Act, 1961, Income-tax is payable by 'every person'. 'Person' includes a 'Hindu Undivided Family' as defined in sec. 2(31). The definition of 'Hindu Undivided Family' is not found in the Income-tax Act. Therefore the expression 'Hindu Undivided Family' must be construed in the sense in which it is understood under the 'Hindu Law' [Surjit Lal Chhabda vs. CIT 101 ITR 776(SC)].

According to Hindu Law, 'Hindu Undivided Family' is a family which consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters. A 'Hindu Undivided Family' is neither the creation of law nor of a contract but arises from status.

A Hindu coparcenary includes those persons who acquire by birth an interest in joint family property. Only a male member of a family can be a coparcener while the membership of a HUF consists of both males and females. All the coparceners of the family constitute what is called a

'Coparcenery'. All the coparceners are members of a HUF but all members of a HUF are not coparceners. A coparcener of a joint family, who acquires by birth an interest in the joint property of the family, whether inherited or otherwise acquired by the family, may have a right to enforce partition whereas the members of the family who are not coparcenars have no right to enforce partition. When a partition takes place, member (mother or widow) of the joint family may get a share equal to the sons and also it is necessary to provide for maintenance and marriage of the unmarried daughter out of family property.

There are two schools of Hindu Law- 1) Mitakshara and 2) Dayabhaga. Under the Mitakshara school, each son acquires by birth an equal interest with his father in the ancestral property. Under the Dayabhaga School which prevails in West Bengal and Assam, a son does not acquire by birth in ancestral property. He acquires interest only on the death of his father. Father enjoys an absolute right to dispose of the property of the family according to his desire. After the death of father, his son does not, by operation of law, become members of the joint family. The sons remain as co-owners with definite shares in the properties left by father unless they decide to live as a joint family.

Case Laws:

i) A single person, male or female, cannot constitute a Hindu Undivided Family. An individual, who has obtained a share on partition of a joint family, has potentialities of creating a joint family; but until he marries, he alone cannot be considered as a joint family. C. Krishna Prasad vs. CIT97 ITR 493.

ii) A joint family may consist of a single male member with his wife and daughter(s) and it is not necessary that there should be two male members to constitute a joint family Gowli Buddanna vs. CIT 60 ITR 193.

Jain & Sikh families are not governed by Hindu Law. However, for the purpose of Income tax Act, such families are treated as 'Hindu Undivided Families'.

The income of a joint Hindu family may be assessed in the status of HUF if the following conditions are satisfied:-

i) there should be a coparcener ship

ii) there should be a joint family property which consists of ancestral property, property acquired with the aid of ancestral property and property transferred by its members. It may be pointed out that once a joint family income is assessed as that of HinduUndivided Family, it will continue to be assessed as such in future years till partition is claimed by its coparceners.

Under the Hindu Law, ancestral property is the property which a person inherits from any of this three immediate male ancestors, i.e. his father, grand father and great grand father. Income of ancestral property is taxable as income of HUF in the following cases:

i) family of husband and wife without any children;

ii) family of two widows of deceased brothers;

iii) family of two or more brothers;

iv) family of uncle and nephew;

v) family of mother, son and son's wife;

vi) family of a person and his late brother's wife;

vii) family of widow mother and her sons.

While computing income of a Hindu Undivided Family one should give due consideration of the following :

i) where a member of HUF converts his self acquired property into joint family, income from such property shall not be treated as income of HUF u / s. 64(2). It shall continued to be taxed in the hands of the transferor who is the member of the HUF.

ii) Income from an impartible estate is taxable in the hands of the holder of the estate and not in the hands of HUF.

iii) income from Stridhan of a woman is not taxable in the hands of HUF.

iv) personal income of members cannot be treated as income of HUF.

v) where the funds of HUF are invested in a company or a firm, fees or remuneration received by the member as a director or a partner in the company or a firm may be treated as income of HUF in case the fees and remuneration is earned essentially as a result of investment funds

vi) where remuneration is paid by HUF to Karta or any other member for services rendered by him in conducting family's business, the remuneration is deductible provided the remuneration is paid :

   i) under a valid bonafide agreement;

   ii) in the interest of, and expedient for the business family, and

   iii) genuine and not unreasonable.

Case law:

i) remuneration and commission received by the Karta of HUF on account of his personal qualifications and exertions and not on account of investments of the family funds in the company cannot be treated as income of HUF. Subbiah Pillai (K.S.) vs. CIT103 Taxman 400 / 237 ITR 11

PARTITION OF HUF

'Partition' may be a (i) total or complete partition (ii) partial partition.

Where all the properties of the family are divided amongst all the members of the family, and the family ceases to exist as an undivided family, it is known as total or complete partition.

On the other hand, where one or more coparceners of the HUF may separate from others and the remaining coparceners may continue to be joint or some of the properties are divided and the balance remain joint it is known as partial partition.

Partial partition is not recognised for tax purposes and as such the joint family shall continue to be liable to be assessed as if no such partial partition had taken place. Each member of such family, immediately before such partial partition and the family shall be jointly and severally liable for any sum payable under the Act. [Sec. 171(9)]

ASSESSMENT OF FIRMS

Partnership firm has been classified for the purpose of computation of income and its assessment as under:

(a) partnership firm assessed as such (PFAS)

(b) partnership firm assessed as an association of person.

Provisions relating to assessment of firms and partners are analyzed as under:–

Particulars	***Sections***
Definition- 'Firm', 'Partner' & 'Partnership'	2(23)
Income includes interest and salary to partners refer to Sec. 28(v)	2(24)
Share of profit from PFAS- not forming a part of total income	10(2A)
Salary to a partner of a firm not taxable under the head 'Salaries'	Expl. to Sec. 15
Charging of interest and salary to partner under the head 'Profits and gains of Business or Profession' excluding the amount disallowed u/s.	40(b)28
Conditions and monetary limits for disallowance of interest and salary to partners	40(b)
Capital gains on transfer of capital asset by a partner to a firm	45(3)
Capital gains on distribution of capital assets to partners on dissolution or otherwise of a firm	45(4)

Restriction to firm on carry forward loss attributable to the retired or deceased partner	78(1)
Amendments of order in case of a partner if any remuneration assessed in his case has been disallowed in the assessment of the firm	155(1A)
Charge of tax on income (other than long term capital gain) in case of a firm	167A
Charge of tax on long term capital gain in case of a firm	112
Conditions to assess the firm as such or as an association of person	184, 185
Change of constitution of firm	187
Assessment in case of a succession of firm	188
Joint and several liability of a partners	188A
Status of the firm and liability of the partners on dissolution or discontinuance of the business of the firm	189

Specific provisions to firm assessed as an AOP

Particulars	*Sections*
Disallowance of salary and interest to partner	40(ba)
Method of computing partner's share in the income of PFAOP	67A
Rate of tax in respect of income of AOP / BOI	167B
Taxability of partner's share of income	86, 110

Assessment of firms and conditions to be fulfilled to avail the status of PFAS [Sec. 184]

Where a firm wants to avail the status of PFAS, it has to satisfy the following conditions:-

i) The firm shall be evidenced by an instrument and the individual shares of the partner shall be specified therein. [Sec. 184(1)]

ii) A certified copy of the instrument of partnership shall accompany the return of income of the previous year relevant to the assessment year 1993-94 or subsequent year in respect of which assessment of the firm is first sought. [Sec.184(2)]

iii) Wherever during a previous year a change takes place in the constitution of the firm or in the sharing ratio of partners, a certified copy of the revised instrument of partnership be submitted along with the return of income of the concerned year of assessment. [Sec. 184(4)]

iv) There should not be any failure on the part of the firm as is specified in Sec. 144 [Sec. 184(5)]

It may be mentioned that once a firm is assessed as PFAS after fulfillment of the above conditions, it will be assessed as PFAS, for every subsequent year provided there is no change in either firm's constitution or partner's profit sharing ratio. However, there should not be any failure mentioned in sec. 144. [Sec. 184(3)]

A partnership deed shall be certified in writing by all the major partners. Where, however, the firm is dissolved and the return is filed after its dissolution, then the copy of deed may be certified by all the major partners in the firm immediately before is dissolution. Where a partner is dead, then it will have to be certified by his legal representative. [Sec. 184(2) Expl.]

Computation of Income

The following provisions should be given due consideration while computing income of a firm-

i) Provision relating to deductibility of remuneration paid to partners by firm.

ii) Provision relating to deductibility of interest paid to partners by firm.

ASSESSMENT OF ASSOCIATION OF PERSONS / BODY OF INDIVIDUALS

Association of Persons:

Where two or more persons voluntarily joint together in a common purpose or action with the object of producing income, Profits and gains they are said to have formed an Association of Persons.

Body of Individuals:

It is a conglomerate of individuals who happen to have come together to carry on sum activity with a view to earn income i.e. co-heirs inheriting shares or securities.

Distinction between AOP & BOI:

i) AOP may consist of non-individuals but BOI has to consist of individuals only

ii) An AOP is a voluntary combination of persons in a joint enterprise or common action to produce income whereas in case of BOI will only consist of two or more persons, may or may not have any common object.

iii) A BOI may become an AOP, but not *vice versa.*

Share of members of AOP / BOI shall be deemed to be indeterminate or unknown, if such shares (in relation to the whole or any part of the income) are indeterminate or unknown on the date of formation of such AOP / BOI or any time thereafter.

Any payment of interest, salary, bonus, commission or remuneration by the AOP/BOI to a member is not allowable as deduction. Where interest is paid by AOP/BOI to a member who has also paid interest to the AOP/BOI, the amount of interest to be disallowed will be limited to the net amount of interest paid by the AOP/BOI. [Sec. 40(ba)]

Tax Rates :

Tax Rates :

	Where shares of members are determinate and known	Where shares of members are indeterminate or unknown
1. None of the members having taxable income	At the rates applicable to individual	At the maximum marginal rate.
2. Any member having taxable income.	At the maximum marginal rate	At the maximum marginal rate.
3. Any member having total Income chargeable to tax	a) Income to the extent of shares of such member or members,	At such higher on rate higher than the maximum marginal rate. .
	b) Balance income of AOP/BOI	taxable at the maximum marginal rate.

Maximum marginal rate means the rate of tax (including surcharge, if any) applicable to the highest slab of income in case of individuals. [Sec.2(29C)]

Ascertainment of member's share in AOP/BOI where shares are determinate and its taxability [Sec. 67A, 86 & 110]

i)Ascertainment of share in AOP/BOI [Sec. 67A]	*Rs.*
Total income of the AOP/BOI	***
Less: Interest, salary, commission or other remuneration paid to any member	***
Balance apportionable to the members in proportion to their shares	***
Share of income allotted to a member	***
Add: Salary, interest, commission or other remuneration received by the member of the AOP or BOI	***
Total share	***
Less: Interest paid on capital borrowed for the purpose of investment in the AOP/BOI	***
Net assessable share income	***

ii)Tax treatment of share income of members [Sec. 86 and Sec. 110]

In computing total income of an assessee, there shall be included share income of a member of an AOP or BOI subject to sec. 86 and 110 of the I.T. Act.

Taxation of AOP/BOI [Sec 167B] hands of members of AOP/BOI	Tax treatment of share income in the . [Sec. 86 & 110]
1 AOP or BOI is taxed at maximum marginal rate higher rate.	Share income of the member is not or at a taxable.
2 AOP or BOI is taxed at normal rates applicable	Share income computed u/s. 67A is included into an Individual. the total income of the member but rebate u/s. 110 at the average of tax in respect of such share income has to be allowed.
3 AOP or BOI is not taxed at all.	Share income will be included in the total income of the member and taxed at the rates applicable to him.

"Average rate of Income-tax" is defined u/s. 2(10) to mean the rate arrived at by dividing the amount of Income-tax calculated on the total income, by such total income.

ASSESSMENT OF COMPANIES

In computing tax incidence companies are classified as follows :

i) Domestic Company

ii) Foreign Company

'Company' means —

i) any Indian company; or

ii) body corporate incorporated outside India under the laws of a foreign country; or

iii) any institution, association or a body which is assessed or was assessable/assessed as a company for any assessment year commencing on or before 1.4.1970; or

iv) 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 Central Board of Direct Taxes to be a company. [Sec. 2(17)]

'Domestic Company' means —

i) an Indian company; or

ii) any other company which, in respect of its income liable to tax under the Act, has made the following prescribed arrangements for the declaration and payment of dividends within India in accordance with Sec. 194 read with Rule 27 of the Rules:

a) The share register of the company for all shareholders should be regularly maintained at its principal place of business in India, in respect of any assessment year, from 1st April of the relevant assessment year.

b) The general meeting for passing of accounts of the relevant previous year and for declaring dividends in respect thereof should be held only at a place within India.

c) The dividends declared, if any, should be payable only within India to all shareholders. [Sec. 2(22A)]

'Foreign Company' means company which is not a domestic company. [Sec. 2(23A)]

'Indian Company' means a company formed and registered under the Companies Act, 1956. Besides, it includes the following:-

a) a company formed and registered under any law relating to companies formerly in force in any part of India;

b) a corporation established by or under a Central, State or Provincial Act;

c) any institution, association or body which is declared by the Board to be a company u/s. 2(17).

d) a company formed and registered under any law in force in the State of Jammu and Kashmir;

e) a company formed and registered under any law for the time being in force in the Union territories of Dadra and Nagar Haveli, Daman and Diu, Pondicherry and State of Goa.

In the aforesaid cases, a company, corporation, institution, association or body will be treated as an Indian company only if its registered or principal office is in India. [Sec. 2(26)]

"Company' in which the public are substantially interested" –

a company is said to be a company in which the public are substantially interested, if-

a) a company owned by Government or Reserve Bank of India or in which not less than 40% shares are held singly or taken together by the Government or the Reserve Bank or a corporation owned by the Reserve Bank; or

b) it is a company registered u/s. 25 of the Companies Act, 1956, i.e., companies incorporated for promotion of Commerce, Arts, Science, Religion, Charity and prohibiting the payment of any dividends to its members; or

c) it is a company having no share capital and it is declared by the CBDT to be a company in which the public are substantially interested; or

d) it is a company which carries on, as its principal business, the business of acceptance

of deposits from its members and which is declared by the Central Government u/s. 620A of the Companies Act to be a Nidhi or Mutual Benefit Society; or

e) it is a company which is not a private company and its equity shares are, as on the last day of previous year, listed in a recognised stock exchange in India; or

f) it is a company which is not a private company and its shares carrying not less than 50% of the voting power (40% in the case of Indian companies whose business consists mainly in the construction of ships or in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power)have been allotted unconditionally to or acquired unconditionally to, or acquired unconditionally by, and were through out the relevant previous year beneficially held by-

   i) the Government; or

   ii) a statutory corporation; or

   iii) a company in which the public are substantially interested or any wholly owned subsidiary of such company.

g) it is a company, wherein equity shares carrying not less than 50% of the voting power have been unconditionally allotted to or acquired by and were through out the relevant previous year beneficially held by, one or more cooperative societies. [Sec. 2(18)]

Taxation of Trust

A.Public Trust u/s. 164(2) —

i) If income is not exempt u/s. 11 or 12, income of Trust is taxable at the rates applicable to an Association of Person.

ii) If the exemption is forfeited due to contravention of sec. 13(1)(c) or 13(1)(d), such income of trust is taxable at minimum marginal rate.

B.Private Trust (shares of beneficiaries are determinate or known) —

i) If income does not include business Profits, the trustee is assessable at the rates applicable to each beneficiary. [Sec. 161(1)]

ii) If income includes profits from business, the whole income is taxable at maximum marginal rate. [Sec. 161(1A)]

C.Private Trust (share of beneficiaries in determinate or unknown) [S. 164(i)] —

i) If income does not include business profits, income is taxable at the rates applicable to an AOP if –

   » none of the beneficiaries has taxable income or is a beneficiary in any other trust.

   » the trust is non-testamentary trust created before 1.3.1970.

   » exclusively for the relative dependents of the settle; or

» it is the only trust declared by a WILL exclusively for the benefit of any dependent relative. In any other case, income is taxable of minimum marginal rate.

ii) If income includes business profits, the whole income is taxable at maximum marginal rate.

D.Oral Trust [Sec. 160(1)(v), Sec. 164A] : "Oral Trust" means a trust which is not declared by a duly executed instrument in writing including any wakf deed which is valid under the Mussalman wakf validating Act, 1913 and which is not deemed to be trust by virtue of explanation I to Sec. 160.

i) Income of Oral trust is taxable at maximum marginal rate.

ii) If Oral trust is declared to be a trust by furnishing a statement in writing containing purposes, particulars and details of trust, beneficiaries and property to the assessing officer within 3 months from the date of declaration of the trust, indicating the share of beneficiaries, the income of the trust is assessable in the hands of trustee at the rates applicable to beneficiaries.

Income from property held under Trust Partly for religious purposes and partly for other purposes [Sec. 164(3)]

Where property is held under trust partly for religious purposes and partly for other purposes and the individual share of the beneficiaries in the income applicable to purposes other than charitable purposes, is not known, the income-tax liability will be aggregated as follows :

i) the tax which would be chargeable on the part of the relevant income which is applicable to charitable or religious purposes (as reduced by the income which is exempt u/s. 11 as if such part were the total income of an association of persons; and

ii) the tax on that part of income attributable to purposes other than charitable or religious and in respect of which shares of beneficiaries are indeterminate or unknown, at the maximum marginal rate.

Where any part of income is not exempt u/s. 11 or 12 by virtue of sec. 13(1)(c) or (d), tax is charged on the relevant income at the maximum marginal rate.

Taxation of non-resident Indian

i)Who is non-resident individual — Sec. 6 [refer to Study Note 1 of study material]

ii)Who is non-resident Indian — An individual who is a citizen of India or a person of Indian origin not resident in India, is called non-resident Indian.

iii)Taxation of non-resident assessees

» Provisions as applicable to resident assessees.

» Special provisions as provided in Sec. 115C to 115I.

The non-resident has an option to be assessed or not to be assessed under special provision for any assessment year. The option is to be exercised by a declaration in his return of Income for

the Assessment Year. [Sec. 115-1]

iv) General Provisions —

Rate of tax Similar to resident assessees.

Special rates of tax on Dividends, interest income from units of Mutual Fund. UTI, bonds or shares purchased in foreign currency and capital gains arising from their transfer.

» 20% of the dividends [which have not been subjected to additional Income Tax u/s 115-O] [other than dividends mentioned in clause (iv) below];

» 20% of the interest received from Government or an Indian concern on monies borrowed or debt incurred in foreign currency;

» 20% of the income received in respect of units purchased in foreign currency, of a Mutual Fund specified u/s 10(23D) or of the Unit Trust India;

» 10% of the interest or dividends [which have not been subjected to additional income tax u./s 115-O], in respect of bonds or Global Depository Receipts in an Indian company purchased in foreign currency and issued under the Foreign Currency Convertible Bonds and Ordinary shares (Through Depository Receipt Mechanism) Scheme, 1993 (commonly known as Euro Issues/Euro Bonds) or in respect of bonds or Global Depository Receipts issued against shares of a public sector company sold by the Government to the non-resident in foreign currency; and

» 10% of the long-term capital gains arising from the transfer of the aforesaid bonds or Global Depository receipts.

v) Filing of return — Similar to resident assessees :

However, a non-resident shall not be required to file a return of income u/s. 139(1), if his total income consists only of income subject to special rates of tax as mentioned in rate of tax under clauses (iv) supra and the tax has been deducted therefrom at source.

Case Laws:

i) For purpose of section 164(1) what is relevant is that income is receivable on behalf of beneficiaries and is not necessary that income is received by beneficiaries - *Gosar Family Trust* v. *CIT* 81 Taxman 146/215 ITR 55.

ii) *Provision merely sets out how tax is to be charged and does not create a charge on the income. CIT* v. *Kamalini Khatau* 209 ITR 101

Transfer Pricing

Introduction

The increasing participation of multi-national groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multi-national group. The profits derived by such enterprises carrying on business in India can be controlled by the multi-national group, by manipulating the prices charged and paid in such intra-group transactions, thereby, leading to erosion of tax revenues. The Finance Act 2001 has introduced detailed provisions relating to transfer pricing, requiring all 'international transactions' between 'associated enterprises' to be at arm's length. These provisions are applicable with effect from 1 April 2001.

The provisions are exhaustive in many respects and generally in line with international practices prescribing methodologies, documentation requirements and penalties.

Scope of application of the Provisions

Any income / expense arising from an international transaction with an associated enterprise must be computed having regard to the arm's-length price. Also, costs or expenses allocated or apportioned between two or more associated enterprises should be determined having regard to arm's-length prices.

The transfer pricing provisions are wide enough to cover transactions between a foreign entity and it's permanent establishment in India.

The transfer pricing provisions would not apply in cases wherein the application of arm's length price results in a downward revision in the income chargeable to tax in India.

International transactions

- The term covers a wide range of revenue and capital transactions between two or more associated enterprises where either or both are non-residents;
- The term also includes arrangements between associated enterprises for cost-sharing in connection with benefits, services or facilities provided to any of such enterprises.

Additionally, another type of transaction is deemed to be an international transaction between two associated enterprises. This is when an enterprise, say X, has entered into a transaction with an unassociated person, say A Ltd. and there exists a prior agreement in relation to this transaction between A Ltd and Y Ltd. (an associated enterprise of X); or the terms of this transaction are determined in substance between A Ltd and Y Ltd.

Computation of arm's-length price

The arm's-length price in relation to an international transaction is to be determined using the most appropriate method out of the specified methods, having regard to the nature or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as may be prescribed.

The five specified methods are:

Comparable Uncontrolled Price Method ('CUP')

A transfer pricing method that compares the price in an international transaction between associated enterprises to the price charged or paid in a comparable uncontrolled transaction. This method makes direct price comparisons between products / services sold to associated enterprises and unrelated parties. The price so determined is adjusted to account for differences, if any, between the international transaction and the uncontrolled transaction or between the enterprises entering into such transaction, which could materially affect the price in the open market.

Resale Price Method ('RPM')

This transfer pricing method is typically used in cases where the property or services are purchased by the taxpayer from the associated enterprise and are resold to an unrelated enterprise. The resale price so arrived at is further reduced by the amount of normal gross profit margin accruing to the taxpayer or to an unrelated enterprise from the purchase and resale of the same or similar property / services, in a comparable uncontrolled transaction. The price so arrived at is reduced by expenses incurred by the taxpayer in connection with the purchase of the property / services, to arrive at the inter-company purchase price of the product from an associated enterprise. The price may be further adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market.

Cost Plus Method ('CPLM')

This transfer pricing method arrives at an arm's length price by using at the outset, the costs incurred by the taxpayer in producing property or in respect of services provided, to the associated enterprise. An appropriate gross profit mark-up to such costs arising from the provision of the same or similar property or services by the taxpayer or by unrelated enterprise, in a comparable uncontrolled transaction is added to such costs to arrive at the arm's length price. In arriving at the appropriate gross profit mark up due adjustments may be made to take into account functional or other differences between the international transaction and the comparable uncontrolled transactions which could materially affect such profit mark-up in the open market.

Profit Split Method ('PSM')

The PSM may mainly be used in case the transactions involve transfer of unique intangibles or in cases where there are multiple transactions amongst associated enterprises, which are so interrelated that they cannot be evaluated separately. This method combines the net profits of all associated enterprises from all such transactions. The relative contribution made by each such associated enterprise including the taxpayer to the earning of such profits, is then evaluated on the basis of the functions performed, assets utilized and risks assumed by each enterprise

and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances. The combined profits are then split amongst the enterprises in proportion to their relative contribution, which is then taken into account to arrive at an arm's length price.

Further, the provisions also provide that the combined net profit may, in the first instance, be partially allocated to each enterprise to provide it with a basic return, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution.

Transactional Net Margin Method ('TNMM')

The TNMM compares the taxpayer's net profit margins, (computed in relation to costs incurred or sales effected or assets utilised by the taxpayer or having regard to any other relevant factor), realised from an international transaction entered into with an associated enterprise to the net profit margin realised by the taxpayer or by an unassociated enterprise from a comparable uncontrolled transaction having regard to the same factors. In arriving at the net profit margin from a comparable uncontrolled transaction, due adjustment may be made to take into account any differences between the international transaction and the comparable uncontrolled transactions, which could materially affect the amount of net profit margin in the open market;

Though the provisions allow for use of any other Method as the Central Board of Direct Taxes may prescribe, no other method has been prescribed till date.

Factors affecting determination of the most appropriate method

The most appropriate method would be the one, which is best suited to the facts and circumstances of the international transactions, and which provides the most reliable measure of an arm's length result in relation to the international transaction. The provisions enlist certain factors, which should be taken into account in selecting the most appropriate method:-

(a) the nature and class of the international transaction;

(b) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

(c) the availability, coverage and reliability of data necessary for application of the method;

(d) the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;

(e) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;

(f) the nature, extent and reliability of assumptions required to be made in application of a method.

Factors establishing comparability

The regulations prescribe certain attributes that should be referred to, to establish comparability:-

(a) the specific characteristics of the property transferred or services provided;

(b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by parties to the transactions;

(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

Use of Multiple year data

It is pertinent to note that the regulations prescribe that the data used in comparing the uncontrolled transaction with the international transaction should relate to the same financial year in which the international transaction was entered into. However, if the previous years' data reveals facts that could have an influence on the determination of transfer prices in relation to the international transactions being compared, then, data relating to a period of up to two years prior to the financial year in which the international transaction is carried out could be considered.

Arithmetic Mean

The provisions specify that where more than one price is determined by the most appropriate method, the arm's length price shall be:

- the arithmetical mean of such prices; or,
- at the option of the assessee, a price, which may vary from the arithmetical mean by an amount not exceeding five percent of such arithmetical mean.

Computation of arm's length price by Assessing Officer

Where the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that—

(*a*) the price charged or paid in an international transaction has not been determined in accordance with the most appropriate method; or

(*b*) any information and document relating to an international transaction have not been kept and maintained by the assessee in accordance with the provisions or

(*c*) the information or data used in computation of the arm's length price is not reliable or correct; or

(*d*) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish

the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction in accordance with the procedure prescribed under the law, on the basis of such material or information or document available with him:

Where an arm's length price is determined by the Assessing Officer he may compute the total income of the assessee having regard to the arm's length price so determined.

No deduction under section 10A, *section 10AA,* or section 10B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this provision.

Cost Accountant's Role in Planning

It is, therefore necessary for the enterprise to maintain appropriate record and transact at ALP. A Cost Accountant can play a significant role in data compilation for and computation of Arm's Length Price.

Expenditure incurred under VRS

Now a days, voluntary retirement scheme are announced by companies for doing away with the excess manpower. Therefore, special provision under section 3DDA has been made for deduction of expenses incurred under a VRS scheme.

Where an assessee incurs any expenditure in any previous year by way of payment to any employee in connection with his voluntary retirement, in accordance with any scheme or schemes of voluntary retirement, one-fifth of the amount so paid shall be deducted in each of the five yeas commencing from that previous year.

Where an Indian company is entitled to the VRS deduction and the undertaking of such Indian company entitled to the said deduction is transferred, before the expiry of the five year period to another Indian company in a scheme of amalgamation, the provisions of this section shall apply to the amalgamated company as they would have applied to the amalgamating company if the amalgamation had not taken place.

Where the undertaking of an Indian company entitled to the VRS deduction is transferred, before the expiry of the period specified in that sub-section, to another company in a scheme of demerger, the provisions of this section shall, as far as may be, apply to the resulting company, as they would have applied to the demerged company, if the demerger had not taken place.

Where there has been reorganisation of business, whereby a firm is succeeded by a company fulfilling the conditions laid down in section 47(*xiii*) or a proprietary concern is succeeded by a company fulfilling the conditions laid down in section 47(*xiv*), the VRS deduction shall, as far as may be, apply to the successor company, as they would have applied to the firm or the proprietary concern, if reorganisation of business had not taken place.

In the year of reorganisation, the predecessor entity shall not be entitled for any deduction.