Tax Laws–JUNE 2011

Answer to Question No 1(a)

I. (a) Rent Received from agricultural land
II. (c) Legal and illegal both
III. (a) May Change
IV. (d) Nil
V. (d) Parent whose total income is greater

Answer to Question No 1(b)

I. Correct: An Indian company is always resident in India no matter where and to what extent its control and management is situated.
II. Incorrect: The residential quarters let out by the assessee to his employees for the purpose of his business shall not chargeable as income from house property
III. Incorrect: Income by way of winning from lotteries in hands of a dealer as regular business activity shall be chargeable under the head Income from profits and gains or profession.
IV. Correct: When it is not possible to ascertain the cost of acquisition and improvement which is required to be deducted from the full value of consideration while computing income from capital gains then income from transfer of such asset is not taxable.
V. Correct: Any payment made in cash or kind in pursuance of any award instituted in the public interest by the government or institute by any other body and approved by the central government is exempt from tax.

Answer to Question No 1(c)

Computation of income from other sources
For the assessment Year 2010-11

(i)	Family pension received from		
	Government of M.P.	15,000	
	Less: 1/3rd exempt u/s 57	5000	10000
(ii)	Royalty	42700	
	Less: Expenses	2700	40000
(iii)	Winning from lottery		90000
(iv)	Winning from Horse Races		
	Grossed up (18000*100)/90		
(v)	Interest from tax free notified bonds		Exempt
(vi)	Dividend from a foreign company		8000
	Income from other sources		218000

Answer to Question No 2(a)

(i) Rs.1,60,000
(ii) 60 days
(iii) One percent, 30 lakh
(iv) Not allowable
(v) Not chargeable

Answer to Question No 2(b)

(i) Belated Return

Any person who has not furnished a return of income within the time allowed to him under Section 139(1) or within the time allowed under a notice issued under Section142(1) may furnish the return for any previous year at any time before the expiry of one year from the end of one year form the end of relevant assessment year or before the completion of the assessment whichever is earlier. In case of belated return, the assessee will be liable to pay interest under section 234A,capital gain loss or business loss cannot be carry forward, and no deduction under section 10a, 10B, 80-IA, 80-IB etc. will be allowed.

(ii) Taxation of zero coupon bonds

The profits arising on the transfer of zero coupon bonds shall be chargeable under the head capital gains. Further Section 2 (42A) has been amended to provide that if such zero coupon bonds are held for not more than 12 months such capital assets shall be treated as short-term capital asset and hence shall be subject to short-term capital gain. On the other hand where these bonds are held for more than 12 months such capital gain shall be treated as long-term capital gain.

Where the tax payable in respect of any income arising from the transfer of a long-term capital assets being zero coupon bonds exceed 10% of the amount of capital gain before giving effect to indexed cost such excess shall be ignored for the purpose of computing the tax payable by the assessee. In other words long-term capital gain shall be chargeable to tax at 10% of LTCG before indexation of cost of such bonds.

(iii) Profit in lieu of salary

Under section 17 (3) of the Income Tax Act the following are deemed to the profits in lieu of or in addition to salary and are taxable in the hands of employee.

1. Terminal compensation: The amount of any compensation due to or received by an assessee from his employer of former employer at or in connection with the termination of his employment or the modification of the terms and conditions.
2. Payment from an unrecognized provident fund or an unrecognized superannuation fund: Payment due to or received by an assessee from an unrecognized provident fund or an unrecognized superannuation fund to the extent of employer's contribution till date and interest thereon.
3. Payment under Keyman Insurance Policy: Any payment due to or received by an employee, under a Keyman Insurance Policy including the sum allocated by way of bonus on such policy, will also be regarded as profit in lieu of salary.
4. Any amount due or received before joining or after cessation of employment: Any amounts due to or received, whether in lump sum of otherwise by any assessee from any person:
   (a) Before his joining any employment with that person; or
   (b) After cessation of his employment with that person.

Answer to Question No 2(c)

Rectification of Mistake

(1) With a view to rectifying any mistake apparent from the record 1542 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 section 143 (1).

Where any matter has been considered and decided in any proceeding by way of appeal or revision relating to an order referred to in sub-section (1), 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 under sub-section (1) 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. (3) 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.

Answer to Question No 3(a)

By virtue of section 61, if an asset is transferred under a revocable transfer, income from such asset is taxable in the hands of the transferor as and when the power to revoke arises. Transfer for this purpose includes any settlement, trust, covenants, agreement or arrangement. This section does not speak of an absolute or unqualified power of revocation. The transferor will be taxable even if the power to revoke has not been exercised so far.

Answer to Question No 3(b)

(i) Mercantile system of Accounting & Cash System of Accounting:

Under the mercantile method of accounting, income and expenditure are recorded at the time of their occurrence during the previous year while under the cash method, revenue and expenses are recorded only when actually received or paid. Under the mercantile method, income accrued during the previous year is recorded whether it is received during the previous year or during any other year while under the cash system income received during the previous year is included in taxable income whether it is earned during the previous year or during any other year. Under the mercantile method, expenditure is recorded when it becomes due during the previous year irrespective of the fact whether it is paid during the previous year or not while under the cash system, expenditure is deductible from the taxable income only if it is paid during the previous year irrespective of the fact whether if relates to the previous year or not under the mercantile method, profit is the amount which represents the amount of earnings accrued during the previous year though not necessarily released in cash while under the cash system income is represented by excess of receipts over disbursements during the previous year.

(ii) Free trade zone and Special economic zone:

Provisions relating to free zone are given under section 10A while provisions relating to special economic zone are given under section 10AA of the Act. In order to get benefit under section 10A, an undertaking must being manufacture or production during the financial year 1980-81 or any subsequent year while under section 10AA the entrepreneur must being to manufacture or produce articles or things or provide services during the financial year 2005-06 or any subsequent year. If a unit is eligible to get deduction under section 10AA.

(iii) Exemption under section 54G is available in respect of transfer of asset in the case of shifting of industrial undertaking from urban area to any other than urban area while exemption under section 54GA is available in case of an industrial undertaking from urban area to a special economic zone which may be situated in urban area.

(iv) Intra-head adjustment and Inter head adjustment
The provisions relating to inter source adjustment have been given under section 70 while the provisions relating to inter-head adjustment are given under section 71 of the Act. In case of intra head adjustment, loss from a source within the same head of income. In case of inter head adjustment, loss under one head of income can be adjusted against income under another source. As per section 70,long term capital loss cannot be set-off from short term capital gains, while section 71, neither long term capital loss nor short term capital loss can be set off from income under other heads of income. As per section 71, loss from business or profession cannot be set off against income under the head salaries.

<u>Answer to Question No 3(c)</u>

Computation of Taxable Income of Mozart Co. a Firm
For the AY 2010-11

Particulars			**Amount**
Computation of Book Profits			
Net Profit as per Profit and Loss account			735200
Add: Inadmissible Expense			
Donations		30000	
Interest on capital in excess of 12%			
Ram	9000		
Shyam	13500	22500	
Remuneration to partners		370000	422500
			1157700
Less: Non-business incomes credited to P&L A/c			
Dividends		28200	
Winnings from Lotteries		140000	168200
			989500
Less: Depreciation			18000
Book Profits			971500

Computation of remuneration allowable to partners	
On first Rs.300000@ 90% or Rs.150000	270000
on balance Rs.621500 @ 60%	372900
Maximum Permissible amount	642900
Actual amount of remuneration is Rs.370000	
therefore amount allowable as remuneration to partners will be Rs.370000	
Income under the head PGBP	
Book Profits	971500
Less: Remuneration to partners	370000
	601500
Income from other sources	
Winning from lotteries	200000
Dividends	exempt
	200000
Gross Total Income	**801500**
Less: Deduction u/s 80G	30000
Total Income	**771500**

Computation of amount of tax	
on winning lotteries [30% on Rs.200000]	60000
on balance of income @ 30%	171450
	231450
Add: EC&SHEC @3%	6944
	238394
Less: TDS on winning from lotteries [30% on Rs.200000]	60000
Tax Payable	178394
Tax payable rounded off	178390

<u>Answer to Question No 4(a)</u>

Computation of Net Wealth of Mr. Raman for the AY 2010-11	
Particulars	**Amount**
(i) Cash in hand (in excess of Rs.50000)	25000
(ii) Cash at bank	Nil
(iii) Residential house exempt u/s5(iv)	Nil
(iv) Land in rural Area	4800000
(v) Land in Urban Area	Nil
(vi) Motor Car for Personal USE	1400000
(vii) Jewellery	600000
(viii) Aircraft for personal use	10000000
(ix) Farm House	2400000

Gross Wealth	**19225000**
Less: Loan on Aircraft	2000000
Net Wealth	17225000
Amount of wealth tax payable by Mr.Raman 1% of [Rs.1722500-3000000]	142250

Answer to Question No 4(b)

I. Winning from Horse Races: Tax is deductible at source from any income by way of winning from horse races @ 30%. TDS is applicable only when income by way of such winnings paid to a person exceeds Rs.2500

II. TDS on fees for professional or technical services or royalty is payable under section 194J. TDS in such case is generally deductible by a person other than an individual or HUF who is responsiblefor paying to a resident person any sum by way of fees for professional services, or fees for technical services or royalty. Tax shall be deducted @ 10%. TDS does not apply when amount of such sum credited or paid or likely to be credited or paid during the financial year to the account of the payee does not exceed Rs.20000 individually for payments for professional services, technical service for royalty or receipts in the nature of non-compete fees and exclusive rights.

III. TDS in respect of payment of compensation on acquisition of immovable property is covered under section 194L. Any person who is responsible for paying to a resident any compensation on account of compulsorily acquisition of any immovable property other than agricultural land is responsible for deducting TDS, Tax is deductible at the time of payment of the sum in cash or by issue of a cheque or draft or any other mode, whichever is earlier. Tax is deductible @ 10%. However, tax is not deductible of the aggregate amount during a financial year does not exceed Rs.100000.

Answer to Question No 4(c)

Payment by way of loan/advance to the extent of accumulated profits by a closely-held company is treated as dividend in the following cases:

Loan or advance is given by a closely held company to a registered shareholder directly or it may be given for the benefit of shareholder or on behalf of shareholder. The shareholder getting the loan beneficially holds 10% or more of equity shares in the company which gives the loan. Such loan or advance is treated as dividend in the hands of the shareholder.

Loan or advance is given by a closely-held company to a concern which may be a HUF, sole proprietor, firm , AOP, BOI or a company; one of the shareholders, beneficially holding at least 10% equity share capital in loan giving company, has a substantial interest in the concern. A person shall be deemed to have a substantial interest in an concern, if he is at any time during the previous year, beneficially, entitled to at least 20% of income of such concern; if such concern is a company then he should beneficially hold at least 20% equity share capital of the company. Such loan or advance is treated as dividend in the hands of the concern.

Loan or advance given to any person on behalf or for the benefit of the shareholder holding 10% share in the loan giving company.

Answer to Question No 5(a)

Computation of Total Income of Mr.Amit For the AY 2010-11		
Particulars		Amount
Net profit as per profit and loss a/c		1555000
Add: Inadmissible Expenses		
Household expenses	20000	
Advertisements	10000	
Expenditure on Scientific Research	50000	
Reserve for bad debts	10000	
Reserve for future losses	20000	110000
Less: Non-business income Credited to P/L		
Gift from friend	70000	
Gift from brother	80000	150000
		1515000
less: Depreciation undercharged		10000
Income from business		1505000
Income from other source		
Gift from friend		
Gift from brother	80000	70000
Total Income		1575000
Less: Deduction u/s 80C		70000
Total Income		1570000

Answer to Question No 5(b)

Conversion of investment into stock-in-trade of a business carried on under section 2(47) with effect from the Assessment Year 1985-86 will be treated as 'transfer' in the year in which Capital asset is converted into stock-in-trade. The national profit arising from transfer by way of conversion of capital asset into stock-in-trade is chargeable to tax in the year in which stock-in-trade is sold. If stock-in-trade is sold in parts in different years, tax on capital gains on conversion of capital asset into stock-in-trade as per Section 45(2), can be said to arise in parts in different years and not in one year in which last of stock-in-trade is sold. For the purposes of computing capital gains in such cases, the fair market value of the capital asset on the date on which it was converted or treated as stock-in-trade shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.

Suppose Mr. X converts his capital asset into stock-in-trade on February, 28, 1985. Fair market value on the date of conversion is Rs.4,00,000. He acquired the asset on August 16, 1970 for Rs. 50,000; fair market value on April 1, 1981 is Rs.70,000. He sells the asset on September 10,2008 for Rs.8,00,000, what will be the amount of long-term capital gains and assessable business profits chargeable to tax taking the CII for 1984-85 to be 125 and for 2008-09 to be 582

Solution: Byvirtue of section 45 (2), long-term capital gains will be taxable for the Assessment Year 2009-10 – the year of transfer of the asset.

Full value of consideration	400000
Less Indexed cost of Acquisition [70000*125/100]	87500
	312500

Business profits chargeable to tax for the assessment year 2009-10 will be

Sale Consideration	800000
Less: FMV on the date of conversion	400000
Business profits	400000

Answer to Question No 5(c)

The Central Board of Direct Taxes (CBDT) has been constituted under the Central Board of Revenue Act, 1963. Itfunctions under the Ministry of Finance. The important powers of CBDT are:

(i) To make rules for carrying out purposes of the Act

(ii) To decide jurisdiction of the Income-tax Authorities

(iii) To issue instructions, orders and directions to other Income-tax authorities for proper administration ofthis Act and all other persons employed in the execution of this Act. However, it cannot issue instructionsto the Commissioner of Income-tax (Appeals). It cannot issue a direction to any Income-tax authority todispose of a case in a particular manner.

(iv) To declare an organization as company

(v) To entertain objections in respect of search and seizure under the Act.

(vii) Power of relaxing any requirement contained in Chapter IV (provisions for computation of income undervarious heads) or Chapter VI-A (provisions for deductions from gross total income)

(viii) Issue such general or special orders for relaxation of the provisions of sections relating to FBT

(ix) Prescribe categories of transactions and documents pertaining to business or profession, where quoting ofPAN is necessary

(x) Frame a scheme in respect of 'Tax Return Preparers'

(xi) Prescribe class of persons by whom return of income [Sec. 139D] and TDS statements [Sec. 200] should befiled electronically.

(xii) Prescribing qualifications for Authorized Representatives

(xiii) Condone delay for seeking CBDT's approval, where it is required [Sec. 293B] and authorize any income taxauthority not being Commissioner of Income-tax (Appeals), to admit belatedly ant claim for exemption, deduction, refund or relief

(xiv) To prescribe method for computation of arm's length price and to prescribe record to be keptand the time for which it is to be preserved

Answer to Question No 6(a)

Computation of Income from House Property For the Assessment Year 2010-11		
(a) If the house is used by the assessee throughout the previous year for his residential purpose		
Annual Value		Nil
Less Interest on Loan		6400
Loss from House Property		6400
Or		
(b) If the house is let out for some period:		
AnnualRental Value of whole house		
Municipal Valuation	24000	
or		
Rent received for 10 months 2000*10	20000	24000
Less Municipal Tax @ 20%		4800
Net Annual Value		19200
Less Deduction under section 24		
(i) Standard Deduction @30% of NAV	5760	
(ii) Interest on loan	4000	
(iii) 1/5 of Interest on loan (3years)		
Construction period: (25000*16%*3*1/5)	2400	12160
Income from HP		7040

Answer to Question No 6(b)

Due Date and Installments

In case of Companies

Due Date	***Amount Payable***
On or before 15th June	not less than 15% of advance tax liability
On or before 15th September	not less than 45% of advance tax liability reduced by the amount already paid
On or before 15th December	not less than 75% of advance tax liability reduced by the amount already paid
On or before 15th March	not less than 100% of advance tax liability reduced by the amount already paid

In case of Other Assessees

Due Date	***Amount Payable***
On or before 15th September	not less than 30% of advance tax liability
On or before 15th December	not less than 60% of advance tax liability reduced by the amount already paid

On or before 15th Marc h	100% of advance tax liability reduced by the amount already paid

Answer to Question No 6(c)

Liability for payment of Advance Tax:

Advance tax shall be payable during a financial year in every case where the tax payable by the assessee during the year is Rs.10,000 or more. An assessee who is liable to pay advance tax is required to estimate his current income and pay advance tax thereon without having to submit any estimate or statement of income to the assessing authorities. After making payment of first/second installment of advance tax, an assessee can revise the remaining installments of advance tax in accordance with his revised estimate of advance tax. Tax can be computed on the current income as estimated by the so computed tax deductible or collectible at source will be deducted.
As regards computation of tax by Assessing Officer, first of all he will have to find out income of the current year on the following basis:

I. Total income of the latest previous year in respect of which the assessee has been assessed by way of regular assessment; or
II. The total income computed by the assessee in the return for any subsequent year, which is higher.

Tax liability on the income of the current year would be calculated according to the rate applicable TDS/TCS will be deducted; Calculation can be made on the similar lines when the assessee wants to make upward downward revision of current income.

As regards payment of advance tax in pursuance of revised orderof Assessing Officer, the total income declared in the return furnished by the assessee for the later previous year or total income in respect of which the regular assessment is made after passing an order by the Assessing Officer but before March 1, shall be taken and income-tax thereon shall be calculated at the rates in force in the financial year. From the tax so determined, TDS or TCS will be deducted.

Answer to Question No 6(d)

The income chargeable under the head "Income from other sources" shall be computed after the followingdeductions, namely –
(a) In the case of dividend income and interest on securities—
(i) Any reasonable sum paid by way of remuneration or commission for the purpose of realizing dividendor interest, and
(ii) Interest on borrowed capital if required for investment in shares or securities.
(b) In the case of income from machinery, plant or furniture let on hire
(i) current repairs to building - sec. 30(a)(ii)
(ii) current repairs to machinery, plant or furniture and insurance premium -sec.(31)
(iii) depreciation on building, machinery, plant or furniture - sec. (32) subject to sec.38 and

(iv) unabsorbed depreciation - sec. 32(2).
(c) In the case of income in the nature of family pension- ` 15,000 or 33.33% of such income whichever is less.
(d) In the case of income specified in sec. 2(24)(x) i.e. deductions from employee salary for any fund, expensesof nature specified in – S. 36(1)(va) i.e. contribution to such fund on or before the due date.
(e) Any other expenditure (not being a personal or capital expenditure) expended wholly and exclusively forthe purpose of earning such income. However, this deduction is not available to a foreign company inrespect of dividend income.

Answer to Question No 7(a)

I. The Director General of Post and Telegraph, Chairman cum managing director of MTNL any person who has been granted a license by the Government under Indian Telegraph Act
II. Insurer or reinsurer providing such services
III. Recipient of such service
IV. Mutual fund or assets management company as the case may be receiving such services
V. Person providing such sponsorship services

Answer to Question No 7(b)(i)

The following categories of persons must obtain registration:

1) Every person liable to pay service tax
2) An input service distributor
3) Every provider of taxable service whose aggregate value of taxable service in a financial year exceeds Rs.900000

Answer to Question No 7(b)(ii)

The time limit for making application for registration under the service tax in respect of different categories of persons is as follows:

1) For persons who are liable to pay service- the application for registration is required to made within 30 days from the date of the commencement of the business
2) For input service distributors- an input service distributor must make the application in Form No. ST-1 within a period of 30 days of the commencement of business
3) For small service providers- the small service providers must make the application in Form No. ST-1 within a period of 30 days of the date in the financial year on which the aggregate value of taxable services has exceeds Rs.900000

Time limit for granting registration- the department is required to issue the registration certificate within 7 days from the receipt of the application. In case of failure to issue registration certificate within 7 days, the registration applied for is deemed to have been granted and the assessee can carry on with his activities. Of course, the service provider is required to mention his registration number in his service.

Answer to Question No 7(c)

I. A registered assessee is required to surrender the registration certificate when he ceases to provide the taxable service in respect of which registration has been obtained to the designated central excise officer/superintendent of central excise
II. Service tax is payable to the government on the amount actually received towards value of taxable services and not on amount charged in the bills/invoice
III. If the assessee pays service tax on the billed amount while he gets fewer amounts from his customers, he is entitled to a refund. In such case the service provider should amend the bill by rectifying the bill or by issuing a revised bill by endorsing the changes in the amount of the bill
IV. The amount of the service tax would be: (12000*10.3)/110.3= Rs.1121
V. The small service provides must make the application in Form No.ST-1 within a period of 30 days of the date in the financial year on which the aggregate value of taxable service has exceeded Rs.900000

Answer to Question No 7(d)(i)

Gross amount charged for taxable service shall include payment for services received before, during or after the provision of taxable service. Therefore, service tax is payable as soon as advance is received even if the service is provided later

Answer to Question No 7(d)(ii)

As per Section 73A(1), if any person who is liable to pay service tax has collected any amount in excess of the service tax assessed or determined and paid on any taxable service, from the service receiver in any manner as representing service tax, he shall pay the amount so collected to the credit of the Central government. Also, if any person has collected any amount of service tax from any person which is not required to be collected, such person shall also pay the amount so collected to the credit of the Central Government. The Central Excise Officer is responsible for collecting such amount be serving notice on the person in question.

Answer to Question No 7(e)

Service tax is a tax imposed by the Central government on taxable services. Taxable service means which is included in the list of taxable service under Section 65. But in the Act small services providers are exempted from paying service tax. 100% exemption from service ax has been granted to a provider of taxable service when aggregate value of taxable service rendered by him from one or more premises, does not exceed Rs.10 lakhs in the preceding Financial Year 2009-10.

In the Union Budget 2008 the exemption limit increased from 8 to 9 lakh. Therefore, such service providers whose annual taxable service is not more than Rs. 10 lakh shall not be covered service tax i.e. they shall not pay service tax on services provided by them.

Answer to Question No 8(i)

As a result of introduction of VAT the CST is to be phased out. The provisions regarding Central Sales Tax are summarized as below:

a) Present CST 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.
b) As a result of introduction of VAT CST has been reduced to 3%. Further from 1.06.2008 the CST rate reduced to 2%.
c) There will be no credit of CST paid on inter-state purchases.
d) If goods are sent on stock transfer outside the state input tax paid in excess of 2% will be allowed as credit. In other words input tax credit to the extent of 2% will not be allowed as credit if goods are sent inter-state.

Answer to Question No 8(ii)

The system of VAT as adopted by states in India though possesses several advantages but still it is deficient on several counts as given below:

a) The general rate of VAT is too high. The general rate of VAT is 12.5% which is very high. This high rate has been fixed to compensate for revenue loss on a large number of commodities and industrial inputs which have been included in 4% rate category and many commodities are covered under the 'exempt' category.
b) Non-inclusion of services – A serious short-coming of the VAT system is the non-inclusion of services up till now though the Central Government may delegate the powers to tax some services to the states.
c) Exemptions – under continuous pressure from various quarters the number of commodities exempted from VAT is still large.
d) Floor Rate – The states in India have two basic rates; general rate of 12.5% and a reduced rate of 4% for precious metals including gold and silver the rate is 1%. These are supposed to be applied uniformly in all states and so these rates are described as floor rates but the states have no power to fix higher or lower rates than these rates. So, this acts as a contradiction in terms in which floor rate is meant. Also, no rebate is given for taxes paid on purchases of goods belonging to the exempted category.
e) Classification of goods – classification of goods under different lists is in many cases, arbitrary and leaves wide room for doubts and disputes as to whether a particular item comes within the lower rate category or not. This is bound to give rise to distortions and inequities in the application of the Tax.
f) Concessional rate for inputs – In no country in general, there is concessional rate for inputs as in India. This goes against the basic idea behind VAT that the end use of a product by the customer should not affect the VAT to be changed and paid by a seller, the system of set off take care in the event when it is used as business input. Also reduced rate of tax on inputs also increases revenue loss from undeclared rates of finished products.
g) The application of VAT on maximum retail price at the first point is a misconducted idea as is being implemented in the case of drugs in west Bengal and Maharashtra. It defeats the purpose of VAT which is to tax sales at all stages with credits for input/purchase taxes so that there is an audit trail at each stage. It also results in diverting investment from the consuming states to the producing states where the first point sellers are located.

Answer to Question No 8(iii)

The essence of VAT lies in providing set-off for the tax paid earlier through the concept of input tax credit/rebate. This concept means setting off the amount of input tax by a registered dealer against the amount of his output tax. The VAT is based on the value addition to the goods, and the related VAT liability of the dealer is calculated by deducting input tax credit from tax collected on sales during the payment period.

Supposing Mr. X purchases raw materials worth Rs. 10,00,000 and records sales in the month of January 2009 of Rs. 15,00,000. The rate of input tax is 4% and rate of output tax is 12.5%. The computation of input tax credit shall be calculated as follows:

		Rs.
Input purchased in January, 2008		10,00,000
Value of Output sold in January		15,00,000
Input tax paid @ 4% on Rs.10 lac		40,000
Output tax collected during January @ 12.5% on Rs. 15 lac		1,87,500
VAT payable for January 2009 after input tax credit		
[Rs.1,87,500 – Rs. 40,000]	1,47,500	

Answer to Question No 8(iv)

Generally, no credit is available in respect of the following purchases:

(a) Goods purchased from unregistered dealers;
(b) Goods purchased from other States/Countries;
(c) Purchase of Goods which are used in manufacture of exempted goods.
(d) Purchase of Capital Goods.
(e) Purchase of Goods used as fuel in power generation.
(f) Purchase of Goods to be dispatched as branch transfers outside states.
(g) Purchase of Goods used in manufacture of goods to be dispatched outside any state as branch transfer/consignments;
(h) Purchase of Goods in cases where the dealer does not have invoices showing amounts of tax charged separately by the selling dealer.
(i) Purchase of non-creditable goods.
(j) Purchase from a dealer who has opted for composition scheme.

Answer to Question No 8(v)

There are three different methods of computation of VAT. These are:

(a) Addition method: under this method identification of Value Added is estimated by adding values of all the element s of production, wages, profits rent and interest. Under this method the incidence of tax evasion is greater because it does not require matching of invoices.

(b) Subtraction method: In this method value addition is computed by means of difference between output and input. This method is also known as the product approach and has further variants, i.e. Direct Subtraction, Intermediate Subtraction and Indirect Subtraction method.

(c) Tax Credit method: Under this method VAT payable by a dealer is arrived at by deducting tax on inputs from the tax on sales. This method is known as the invoice method. This method is universally used because of advantages of computing tax liability under the method. As rate of tax is different in respect of inputs and outputs the addition method and the subtraction method are not practicable in case of a manufacturer.