INDIRECT TAXES

Government has to perform many functions in the discharge of its duties like infrastructure development, health, education, defence of the country, removal of poverty, maintenance of law and order, etc. To meet these requirements huge amount of capital is required. The question arises, from where does government get money for fulfilling all these activities and for the development of the nation? The government collects money from public through a wide variety of sources i.e. fees, fines, surcharges and taxes which are defined later in this lesson. The most important of these is taxation. In this lesson we will discuss various types of indirect taxes in details.

OBJECTIVES

After studying this lesson, you will be able to:

- acquaint yourself with the sources of revenues of the government;
- define direct taxes and indirect taxes;
- distinguish between direct taxes and indirect taxes;
- state merits and demerits of direct taxes and indirect taxes;
- enumerate sources of direct taxes and indirect taxes;
- define various types of indirect taxes like, excise duty, customs duty(import and export),production linked tax, and Value Added Tax (VAT); and
- distinguish between sales tax and value added tax.

EXPECTED BACKGROUND KNOWLEDGE

- Concept of percentage and its applications

SOURCES OF REVENUE

As we know that government has to perform its various functions for the welfare of the society, so it requires revenue. The income of government from all sources is called public income or public revenue. Public revenue includes income from taxes, income from goods and services supplied by public enterprises, revenue from the administrative activities, such as fees, fines, etc., gifts and grants, while public receipts include all the income of the government which it may have during a given period of time i.e. public receipts = public revenue + income from all other sources, such as, a public borrowing from individuals and banks and income from public enterprises. Local bodies like Municipal Corporation, Municipal Committees, Town Panchayat, Cantonment Board, etc can also levy certain taxes like property tax, professional tax, octroi, education cess, etc.

Thus, taxes are contributions made by the citizens of the country towards its development and expenditure, which the government has to incur in its social and economic activities. Taxes are paid by the individuals, corporate houses of trade and industry etc. There are different types of taxes like income tax, wealth tax, gift tax, property tax, sales tax, excise and custom duty etc.

Tax

A tax is legally compulsory payment levied by the government on the persons or companies to meet the expenditure incurred on conferring common benefits upon the people of a country. In other words a tax can also be describe as a compulsory levy where those who are taxed have to pay the sums irrespective of any corresponding return of services or goods by the government.

Fee

Fee is also compulsory payment made by a person who receives in return a particular benefit or services from the government.

Fines

These are compulsory payments without any quid pro que but are different from taxes because fines are imposed to curb certain offences and discipline people and not to get revenue for the State. In this sense, fines are not taxes.

Surcharges

It is an additional charge or an extra fee for a special service. It is also called tax on tax e.g. a 10% surcharge is applicable on income tax for incomes above Rs. 10 lakh. In other words surcharges are often a charge in addition to a charge, or a tax added to the original tax.

Two aspects of tax follow from the definition:

1. A tax is a compulsory payment and no one can refuse to pay it.
2. Proceeds from taxes are used for common benefits or general purposes of the state. It means there is no direct quid pro que involvement in the payment of a tax.

Taxes are mainly classified into direct and indirect taxes:

DIRECT TAXES

Those taxes whose burden cannot be shifted to others and the person who pays these to the government has to bear it are called direct taxes. In other words direct tax is imposed on an individual or a group of individuals, which affects them directly i.e, which they have to pay to the government directly. The direct tax can be of different types:

Income Tax

The tax imposed on an individual or a group of individuals on their annual incomes is known as income tax. Every individual whose annual income exceeds a certain specified limit is required, under the Income Tax Act, to pay a part of his income in the form of income tax. Its rates are announced in the beginning of each financial year by the central government.

Financial Year: The period from 1st April to 31st march is taken as a financial year i.e. every financial year begins on 1st April and ends on 31st march of the consecutive year.

Assessment Year: The year next to a particular financial year is called the assessment year for that financial year, e.g. for financial year 2005-06, the assessment year is 2006-07.

Permanent Account Number: An individual is given a permanent account number (PAN) by the income tax department. He or she is obliged to file an income tax return of the financial year by a specified date of the subsequent financial year.

Wealth Tax

The tax imposed on the wealth (property as well as money) of an individual is called wealth tax. The exemption limit for wealth tax is Rs 5, 00,000. In addition one residential house or a part thereof is exempted from the wealth tax.

Gift Tax

If an individual transfers any of his movable or immovable property voluntarily to any other individual it is called a gift. If the value of a gift exceeds a specified limit then the person giving the gift has to pay gift tax to the government where as the person receiving the gift need not pay any tax.

A controversial issue in public finance is concerned with whether in the tax structure of an economy, direct or indirect tax should be preferred. Indeed both direct taxes and indirect taxes have their merits and demerits and therefore a good tax system should contain a proper mix of these two types of taxes.

Direct taxes, it may be recalled are those which are levied directly on the individuals and firms and their burden is borne by those on whom these are levied.

Merits of Direct Taxes

1. The larger burden of the direct taxes falls on the rich people who have capacity to bear these and the poor people with less ability to pay have to bear less burden.
2. Direct taxes are important instrument of reducing inequalities of income and wealth.
3. Unlike indirect taxes, direct taxes do not cause distortion in the allocation of resources. As a result these leave the consumers better off as compared to indirect taxes.
4. Revenue elasticity of direct taxes, especially if they are of progressive type is quite high. As the national income increases, the revenue on these taxes also rises a great deal.

Demerits of Direct Taxes

1. In the direct taxation, people are aware of their tax liability and therefore they would try to avoid or even evade the taxes. The practice and possibility of tax evasion and avoidance

is more in direct taxes than in case of indirect taxes.

2. Direct taxes are generally payable in lump sum or even in advance and become quite inconvenient.

3. Another demerit of direct taxes is their supposed effect on the will to work and save. It is assessed that work (given Income) and leisure are two alternatives before any taxpayer. If therefore, a tax is imposed say on income, the taxpayer will find that the return from work has decreased as compared with return from leisure. He therefore tries to substitute leisure for work.

INDIRECT TAXES

Indirect taxes are those whose burden can be shifted to others so that those who pay these taxes to the government do not bear the whole burden but pass it on wholly or partly to others. Indirect taxes are levied on production and sale of commodities and services and small or a large part of the burden of indirect taxes are passed on to the consumers. Excise duties on the product of commodities, sales tax, service tax, customs duty, tax on rail or bus fare are some examples of indirect taxes.

Excise Duty

The tax imposed by the government on the manufacturer or producer on the production of some items is called excise duty. The liability to pay excise duty is always on the manufacturer or producer of goods. The duty being a duty on manufacture of goods, it is normally added to the cost of goods, and is collected by the manufacturer from the buyer of goods. Therefore it is called an indirect tax. This duty is now termed as "Cenvat". There are three types of parties who can be considered as manufacturers-

- Those who personally manufacture the goods in question
- Those who get the goods manufactured by employing hired labour
- Those who get the goods manufactured by other parties

For example, excise duty on the production of sugar is an indirect tax because the manufacturers of sugar include the excise duty in the price and pass it on to buyers. Ultimately it is the consumers on whom the incidence of excise duty on sugar falls, as they will pay higher price for sugar than before the imposition of the tax.

In order to attract Excise duty liability, following four conditions must be fulfilled:

a) The duty is on "goods".

b) The goods must be "excisable"

c) The goods must be "manufactured" or produced.

d) Such manufacture or production must be "in India".

Additional Information on Excise Duty

Goods : These are the entities, which can be weighted, measured and marketed. e.g. steel, cloth, computer software, gas, etc. Those commodities having very short life are not goods, if not marketable in that short period, even if there is a specific entry in the tariff.

Excise duty can only be levied on those items, which are manufactured in India but excluding goods produced or manufactured in Special Economic Zones (SEZ). Thus, excise levy cannot be imposed on imported goods.

Payment of excise duty : In case of Non-SSI (Small Scale Industries) i.e., normal assesses the excise duty is payable monthly, and for SSI (availing exemption based on turnover) it is payable quarterly. The duty on the goods removed from the factory or the warehouse during the month shall be paid by the 5th of the following month in case of Non-SSI and by 15th for SSI. In case of delayed payment, interest should also be deposited at the rate of 13% p.m or Rs 1,000 per day for the period of delay after 5th or 15th whichever is applicable, whichever is higher, along with the duty.

Payment by debit in Cenvat credit account: Under the Cenvat credit scheme, the assessee is allowed credit of duty paid on inputs or capital goods, which are used in or in relation to manufacture of the final products, and the credit can be utilized towards payment of duty on the final products. Credit is allowed on inputs and capital goods except LDO (light diesel oil), HSD (high speed diesel) and motor spirit. Also, instant credit is allowed immediately on the inputs being received into the factory. However credit is not allowed if final products are exempted from duty.

Following example will illustrate the credit method of Cenvat.

Let the price of the commodity be Rs 100, When the transaction takes place without cenvat, B purchases from A at Rs 110,(10% as excise duty). After addition a value of Rs 40, the subtotal is Rs 150.He pays 10% tax on it (i.e Rs15) then total is 165. As against this, in the second case, when transaction takes place with Cenvat, B purchases from A at Rs 100 because he got credit on that amount. After adding the same value of Rs 40, the sub total is Rs 140, He has to pay 10% of excise on Rs 140,i.e Rs 14, then total becomes Rs. 154. Here you can observe easily that transaction with Cenvat is clearly beneficial. The details are exhibited in the following tabular form:

	Transaction without Cenvat		**Transaction with Cenvat**	
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

Exemption from Payment of Excise Duty: Central excise rules grant exemption from duty if goods are exported under bond, except exports to Nepal and Bhutan. Similarly, goods manufactured in Special Economic Zones (SEZ) are not excisable and hence no excise duty can be levied on goods manufactured in SEZ. Certain other items, which are exempted for excise duty, are enlisted in **Annexure-'A',** given at the end of this lesson.

Generally 16% excise duty and 2% cess on it are imposed on most goods, but government can fix different tariff values for different classes of goods or goods manufactured by different classes or sold to different classes of buyers. Few exceptions like the following are there in case of Textile sector.

Sl. No.	Type of Goods	Excise Duty	Cess
1.	Unprocessed fabrics of cotton, man-made (synthetic) and woolen other than (2) given below.	10%	2%
2.	Unprocessed knitted or crocheted fabric of cotton not containing any other textile materials.	8%	2%
3.	If readymade garments are made up of 100% cotton fabrics and also knitted or crocheted	8%	2%
4.	Readymade garments other than (3) above	10%	2%
5.	All types of clothing accessories if made up of 100% cotton and also knitted or crocheted.	8%	2%
6.	Clothing accessories other than (5) above.	10%	2%

40.3.3 Valuation for Excise Duty

Specific duty: It is the duty payable on the basis of certain unit e.g. duty on cigarettes is on length basis, sugar per quintal basis, matches per 100 boxes, marble slabs and tiles per square meter basis and colour TV by screen size in cm, if MRP is not written on the carton.

Tariff Value: Government from time to time fixes tariff value. Government can fix different tariff values for different classes of goods manufactured by different classes or sold to different classes of buyers.

MRP based valuation : The provisions are as follows:

i) The goods should be covered under provisions of Standards of Weights and Measures Act.

ii) Central Government can permit reasonable abatement (deductions) from the retail sale price.

iii) Central Government has to issue a notification in Official gazette specifying the commodities for which the provision is applicable and the abatement permissible.

For example, government had issued a notification to reduce the excise duty on cosmetics and toilet preparations on MRP basis printed on the carton after allowing abatement of 50%. In such cases, if MRP printed on carton is Rs 50 and if the duty on cosmetics & toilet preparations is 20%, the duty @ 20% will be payable on Rs 25 (i.e after allowing 50% abatement of MRP of Rs 50). Thus duty payable per pack will be Rs. 5.00.

Assessable Value: The basic provision of assessable value, when excise duty is chargeable on excisable goods with reference to value will be transaction value on each removal of goods. Transaction value is defined as 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, including any amount charged 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 excise duty, sales tax and other taxes.

Export benefits under Central Excise

Inputs free of duty: Exporting units need raw materials without payment of customs/excise duty, to enable them to compete for exporting.Exports free of duty on finished product: exports of almost all excisable goods except hides, skins and leather and salt and exports to all countries except to Nepal and Bhutan are exempted from central excise duties.

Example Shivam Enterprises, manufactures 60 units of steam irons per day, and its input cost is Rs.200 per unit. The company adds a value of Rs.100 and then sells it after paying 10% excise duty. Calculate the final price of each steam iron, and how much total duty has been paid at the end of the month when the transaction is without Cenvat.

Solution : Input Cost = Rs. 200 per unit

Value added = Rs.100

Total = Rs. 300

for 60 units per day in a month = 60 x 30 = 1800 units

Duty paid = $Rs.300 \times 1800 \times \frac{10}{100}$ = Rs. 54,000

Example 40.2 Ganesh and Sons, produce 100 kgs chocolate biscuits per day at the cost of Rs. 50 per kg. If the excise duty is 5%, then how much duty has to be paid at the end of the month, if Rs. 20 per kg is added to the cost.

Solution: Input Cost per kg. = Rs. 50

Value added = Rs. 20

Total = Rs. 70

Duty for one month = $Rs.[70 \times 100 \times 30 \times \frac{5}{100}]$ = Rs. 10500

Example Sharma and Company manufactures 5 quilts a day and uses cotton fiber (Rs.100 per kg) and cotton cloth (Rs.50 per meter) as input. In making one quilt 2 kgs of cotton fibre and 5 meters of cloth are used. If excise duty on cotton fiber is 8% and on cloth it is 10% while on quilt it is 12%, calculate the total duty paid to the government in one month when the value added by the Company is Rs.109 per quilt, if the transaction is (i) **without Cenvat** (ii) **with Cenvat**.

Solution :Input cost of 1 quilt = $Rs. (2 \times 100 + 5 \times 50)$

= Rs. 200 on cotton fiber + Rs. 250 on cloth.

$\therefore$ (i) Without Cenvat (for one quilt)

Cotton Fibre = Rs. 200		Cloth = Rs. 250
+ Rs. 16		+ Rs. 25
Rs. 216		Rs. 275

Total for 1 quilt = Rs. (216 + 275) = Rs. 491