

CONCEPTS AND GENERAL PRINCIPLES OF SERVICE TAX

Question 1

Answer the following:-

- (a) Is an unincorporated association, formed after 1st June, 2006, liable to pay any service tax? (2 Marks) (May, 2007)
- (b) Briefly explain the nature of service tax. (2 marks) (May, 2008)
- (c) Explain as to how and when the amendments made in Finance Bill, in respect service tax matters come into force? (2 Marks) (Nov, 2008)

Answer

- (a) With effect from 01.05.2006, the Finance Act, 2006 inserted an explanation after section 65(121) of the Finance Act, 1994. The explanation states that taxable service includes any taxable service provided or to be provided by any unincorporated association or body of persons to a member thereof, for cash, deferred payment or any other valuable consideration.
Thus, an unincorporated association providing service to its members can also be a "person" for purpose of service-tax, and be liable to pay service tax.
- (b) Service tax is a tax on services. This is not a tax on profession, trade, calling or employment but is in respect of service rendered. If there is no service, there is no tax. Basically, service is a value addition that can be perceived but cannot be seen, as it is intangible; however, usage of some goods during the course of rendering the service would not mean that there is no 'service'. It is the predominant factor in each case, which is to be studied to arrive at a conclusion.
- (c) Amendments made by the Finance Bill, in respect of service tax matters, come into force from the date of enactment of the Finance Bill i.e., the date on which the Finance Bill receives the assent of the President of India. However, wherever it is specifically provided so in the Finance Bill, certain amendments like new taxable services introduced vide the Finance Bill and alteration in the scope of existing

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taxable services, become effective from a date to be notified after the enactment of the Finance Bill.

Question 2

Answer the following:

- (a) What are the sources of service tax law? (3 Marks) (June, 2009)
(b) Which Act and Rule govern the levy of service tax in India? (3 Marks) (Nov, 2009)

Answer

- (a) There is no independent statute on service tax as yet. However, the sources of service tax law are:-
- (i) Finance Act, 1994
 - (ii) Rules on service tax
 - (iii) Notifications on service tax
 - (iv) Circulars or Office Letters (Instructions) on service tax
 - (v) Orders on service tax and
 - (vi) Trade notices on service tax
- (b) Finance Act, 1994 and the rules made there under govern the levy of service tax in India. The significant rules relating to service tax are the Service Tax Rules, 1994, Service Tax (Determination of Value) Rules, 2006, Export of Services Rules, 2005 etc.

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CHARGE OF SERVICE TAX, TAXABLE SERVICES AND VALUATION

Question 1

Answer the following:-

Will the payment to a hotelier of Rs.10,000 on behalf of an architect by a service receiver be included in the value of taxable services? (2 Marks) (May, 2007)

Answer

Service tax chargeable on any taxable service is on the basis of gross amount charged by service provider for such service provided or to be provided by him. It is not necessary that the service receiver should pay the consideration only to the service provider; any money paid to the third party is also includible. Hence, the hotel bill met by the client would be includible in the value of taxable services.

Question 2

Answer the following:

- (a) Can it be said that if the taxable service is not capable of ascertainment, the same cannot form part of value of taxable services from May, 2006 onwards? (3 Marks) (May, 2007)
- (b) Briefly explain about the charge of service tax. (3 Marks) (May, 2008)
- (c) How is the value of taxable services determined when the consideration against taxable services is received in other than monetary terms? (3 Marks) (June, 2009)

Answer

- (a) No, it cannot be said so. With effect from 18.4.2006, the Finance Act, 2006 has introduced detailed provisions for valuation of taxable services. The provisions of section 67, as amended, state clearly that if the consideration for a taxable service is not ascertainable, the value of such service shall be the amount as may be determined in the prescribed manner.

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- (b) Section 66 is the charging section of the Finance Act, 1994 ("the Act") which deals with the levy and collection of service tax. It provides the applicable rate of service tax which is to be levied on the value of various taxable services. The prescribed manner for collection and payment of tax is provided in the Service Tax Rules, 1994. With effect from 18.04.2006, the rate of service tax prescribed by section 66 is 12% of the value of taxable services referred to in section 65(105) of the Act.

However, it may be noted that Notification No. 8/2009 ST dated 24.02.2009 exempted all the taxable services specified in sub-section (105) of section 65 of the Finance Act from so much of service tax leviable thereon under section 66 of the Finance Act, as is in excess of the rate of 10% of the value of taxable services. Therefore, the effective rate of service tax is 10%.

- (c) Section 67 of the Finance Act, 1994 as amended provides that if the consideration for a taxable service is not wholly or partly in terms of money, then the value of such service shall be such amount in money, with the addition of service tax charged, is equivalent to the consideration.

Question 4

Ms. Priya rendered a taxable service to a client. A bill for Rs. 40,000 was raised on 29.4.2007; Rs. 15,000 was received from the client on 1.5.2007 and the balance on 23.5.2007. No service tax was separately charged in the bill. The questions are:

- (a) Is Ms. Priya liable to pay service tax, even though the same has not been charged by her?
- (b) In case she is liable, what is the value of taxable service and the service tax payable? (2+4 Marks) (May, 2008)

The provisions as amended by the Finance (No.2) Act, 2009 and notifications and circulars issued up to October 31, 2009 may be taken into consideration while solving this question. Hence, the facts of the question may be read accordingly.

Answer

Section 68 of the Finance Act, 1994 casts the liability to pay service tax upon the service provider or upon the person liable to pay service tax as per rule 2(1)(d). This liability is not contingent upon the service provider realizing or charging the service tax at the prevailing rate. The statutory liability does not get extinguished if the service provider fails to realize or charge the service tax from the service receiver. Hence, Ms. Priya is liable to pay service tax.

However, sometimes it may happen that the assessee is not able to charge service tax because of the nature of service or he fails to recover the service tax from the client / customer as he is not aware that his services are taxable. Hence, in these cases, the amount recovered from the client in lieu of having rendered the service will be taken to be inclusive of service tax and accordingly tax payable will be calculated by making back calculations.

Charge of Service Tax, Taxable Services and Valuation

The rates of service tax payable are:

Basic rate		10%
Education cess (2% of 10%)	=	0.20%
Secondary and higher education cess (1% of 10%)	=	0.10%
Effective rate of service tax	=	10.30%

Service tax is payable on receipt basis

Value of taxable service		$= \frac{\text{Gross amount charged}}{(100 + \text{Effective rate})} \times 100$
Value of taxable service	=	$\frac{40,000 \times 100}{110.30} = \text{Rs. } 36,265$
Service tax payable	=	$\frac{40,000 \times 10.30}{110.30} = \text{Rs. } 3,735$

Question 5

J.C. Professionals, a partnership firm, gives the following particulars relating to the services provided to various clients by them for the half-year ended as on 30.09.06:

- (i) Total bills raised for Rs. 8,75,000 out of which bill for Rs. 75,000 was raised on an approved International Organisation and payments of bills for Rs. 1,00,000 were not received till 30.09.06.
- (ii) Amount of Rs. 50,000 was received as an advance from XYZ Ltd. on 25.09.06 to whom the services were to be provided in October, 06.

You are required to work out the:

- (a) taxable value of services
- (b) amount of service tax payable. (3 Marks) (Nov, 2007)

The provisions as amended by the Finance (No.2) Act, 2009 and notifications and circulars issued up to October 31, 2009 may be taken into consideration while solving this question. Hence, the facts of the question may be read accordingly.

Answer

Computation of taxable value of services provided by the J.C. Professionals for the half year ending on 30.09.2006:

	Rs.	Rs.
Particulars		
Total bills raised		8,75,000
Less: Bill raised on an approved International Organisation (Note 1)	75,000	

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Less: Bills for which payments have not been realized (Note 2)	1,00,000	1,75,000
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		7,00,000
Add: Advance received for the services to be provided in October '09 (Note 3)		50,000
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Taxable value of services		7,50,000
Computation of service tax payable		
Taxable value of services		7,50,000
Service tax @ 10%		75,000
Add: Education cess @ 2%		1,500
Add: Secondary and higher education cess @ 1%		750
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Total Service tax payable		77,250

Notes:

1. Services provided to an International Organisation are exempt from the service tax vide Notification No. 16/2002 ST dated 02.08.2002.
2. Service tax is payable only when the value of taxable services is actually received [Rule 6 of the Service Tax Rules, 1994].
3. Any advance received for providing any taxable services forms part of the value of taxable service [Section 67 of the Finance Act, 1994].

Question 7

Ms. Priyanka, a proprietress of Royal Security Agency received Rs.1,00,000 by an account payee cheque as advance while signing a contract for providing taxable service. She received Rs.5,00,000 by credit card while providing the service and another Rs.5,00,000 by a pay order after completion of service on January 31, 2009. All three transactions took place during financial year 2008-09. She seeks your advice about her liability towards value of taxable service and the service tax payable by her.

(5 Marks) (Nov, 2009)

The provisions as amended by the Finance (No.2) Act, 2009 and notifications and circulars issued up to October 31, 2009 may be taken into consideration while solving this question. Hence, the facts of the question may be read accordingly.

Answer

Computation of taxable service of Ms. Priyanka for financial year 2008-09

Particulars	Rs.
Advance received by an account payee cheque	1,00,000
Amount received while providing service through credit card	5,00,000

Charge of Service Tax, Taxable Services and Valuation

Amount received on completion of service by a pay order	<u>5,00,000</u>
Value of taxable service	<u>11,00,000</u>

Calculation of service tax liability

Particulars	Rs.
Service tax @10% on Rs.11,00,000	1,10,000
Add: (i) Education cess @ 2% on service tax	2,200
Add: (ii) Secondary and higher education cess @ 1% on service tax	<u>1,100</u>
Total service tax payable	<u>1,13,300</u>

Notes:

1. Money includes any cheque, pay order, currency, promissory note, letter of credit, draft, traveller's cheque, money order, postal remittance and other similar instruments but does not include currency that is held for its numismatic value.
2. Gross amount charged includes payment by credit card, cheque, deduction from account and any form of payment by issue of credit notes/debit notes and book adjustment.

UNIT-1: PAYMENT OF SERVICE TAX

Question 1

Answer the following questions:-

- (a) Should service tax be paid even if not collected from the client or service receiver?
(2 Marks) (May, 2007)
- (b) Where a service provider maintains books of accounts on mercantile basis relating to taxable services provided by him, will service tax be payable on accrual basis?
(2 Marks) (Nov, 2007)
- (c) Is a service provider allowed to pay service tax on a provisional basis?
(2 Marks) (Nov, 2007)
- (d) A particular service has been brought into the service tax net with effect from 1.6.2007. Mr. Vignesh has provided this service on 20.5.2007; the payment for the same was received on 10.6.2007. Is service tax payable on the same?
(2 Marks) (May, 2008)

The provisions as amended by the Finance (No. 2) Act, 2009 and notifications and circulars issued up to October 31, 2009 may be taken into consideration while solving this question. Hence, the facts of the question may be read accordingly.

- (e) Mr. Saravanan has collected a sum of Rs. 15,000 as service tax from a client mistakenly, even though no service tax is chargeable for such service. Should the amount so collected be remitted to the credit of the Central Government?
(2 Marks) (May, 2008)
- (f) Who is liable to pay e-payment of service tax? (2 Marks) (Nov, 2008)
- (g) Whether life insurer carrying on life insurance business has option to calculate service tax at different rate? (2 Marks) (Nov, 2008)
- (h) Mr. X, a service provider who pays service tax regularly, was of the opinion that a particular service was not liable for service tax. He, therefore, did not charge service

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tax in his bill. He received the bill amount without service tax. How will service tax liability of Mr. X be determined in such case? (2 Marks) (June, 2009)

- (i) How can the excess payment of service tax be adjusted? (2 Marks) (June, 2009)

Answer

- (a) Section 68 of the Finance Act, 1994 casts the liability to pay service tax upon the service provider or upon the person liable to pay service tax as per rule 2(1)(d) of the Service Tax Rules, 1994. This liability is not contingent upon the service provider realizing or charging the service tax at the prevailing rate. The statutory liability does not get extinguished if the service provider fails to realize or charge the service tax from the service receiver.
- (b) Service tax is not payable on accrual basis and the method of accounting is irrelevant for making payment of service tax. Service tax is payable to the Government only when any payment is received-whether in advance or after the bill is raised-from the client or service receiver for the taxable services provided.
- (c) In case the assessee is unable to correctly estimate, at the time of the deposit, the actual amount of service tax for any month or quarter, he may make a written request to Assistant/Deputy Commissioner of Central Excise for making payment of service tax on provisional basis. The concerned officer may allow payment of service tax on provisional basis on such value of taxable service as may be specified by him.
- (d) No service tax is payable for the part or whole of the value of services, which is attributable to services provided during the period when such services were not taxable. The time of receipt of payment towards the value of services will not be relevant for this purpose. For the service tax to be leviable, on the date on which the service was rendered, it should be exigible to the levy.

In the given case, Mr. Vignesh has provided the service on 20.05.2009 and has received the payment on 10.06.2009. Assuming that, the invoice was raised by Mr. Vignesh before 01.06.2009, he will not be liable to collect service tax.

- (e) Section 73A of the Finance Act, 1994 casts an obligation on every person who has collected service tax from any recipient of service in any manner as representing service tax, to remit the same to the credit of the Central Government. On account of this provision, where any person has collected any amount, which is not required to be collected from any other person, in any manner as representing service tax, he should also immediately pay the amount so collected to the credit of the Central Government.

Hence, Mr. Saravanan has to remit the service tax collected by him on the non taxable services to the credit of the Central Government before the due date.

- (f) With effect from 01.10.2006, the assessee who has paid service tax of Rs.50,00,000/- or above in the preceding financial year or has already paid service tax of Rs.50,00,000/- in the current financial year has to compulsorily deposit the service tax liable to be paid by him electronically, through internet banking.

- (g) An insurer carrying on life insurance business who is liable for paying service tax has the option to pay an amount calculated @ 1% of the gross amount of premium charged by him towards the discharge of his service tax liability instead of paying service tax at the rate specified in section 66 of Chapter V of the Act. However, such option is not available in cases where:
- (i) the entire premium paid by the policy holder is only towards risk cover in life insurance; or
 - (ii) the part of the premium payable towards risk cover in life insurance is shown separately in any of the documents issued by the insurer to the policy holder.
- (h) Section 68 of the Finance Act, 1994 casts the liability to pay service tax upon the service provider or upon the person liable to pay service tax as per rule 2(1)(d) of the Service Tax Rules, 1994. This liability is not contingent upon the service provider realizing or charging the service tax at the prevailing rate. The statutory liability does not get extinguished if the service provider fails to realize or charge the service tax from the service receiver. In this case, the amount received from the service receiver will be taken to be inclusive of service tax. Accordingly, service tax payable by the service provider shall be ascertained by making back calculations in the following manner:-

$$\text{Service tax payable} = \frac{\text{Amount received} \times \text{Service tax rate}}{(100 + \text{Service tax rate})}$$

- (i) Where an assessee has paid to the credit of Central Government any amount in excess of the amount required to be paid towards service tax liability for a month or quarter, as the case may be, the assessee may adjust such excess amount paid by him against his service tax liability for the succeeding month or quarter, as the case may be. However, such an adjustment would be subject to the following conditions mentioned below:
- (i) Self-adjustment of excess credit would not be allowed in case of reasons involving interpretation of law, taxability, classification, valuation or applicability of any exemption notification.
 - (ii) Excess amount paid and proposed to be adjusted should not exceed Rs.1,00,000 for the relevant month or quarter except in case of assessee's opting for centralized registration.
 - (iii) Adjustment can be made only in the succeeding month or quarter.
 - (iv) The details of self-adjustment should be intimated to the Superintendent of Central Excise within a period of 15 days from the date of such adjustment.

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Question 2

Answer the following:

- (a) An assessee who has collected service tax from a client is unable to perform the service. Briefly explain the situations in which and the conditions subject to which he can adjust the service tax relating to above, against his forthcoming service tax liability. (3 Marks) (May, 2007)
- (b) Who is liable to pay service tax in relation to services provided by a goods transport agency? (3 Marks) (Nov, 2007)
- (c) Mr. Vasudevan has rendered freely, a service to a client which is taxable, but has not charged or received any fee from the client. Is service tax payable on such free service? (3 Marks) (May, 2008)
- (d) What are the due dates for payment of service tax? (3 Marks) (Nov, 2007) (Nov, 2008)

Answer

- (a) An assessee may adjust excess payment of service tax against his liability of service tax for subsequent periods. Where an assessee has deposited service tax in respect of a taxable service which is not so provided by him either wholly or partially for any reason, he may adjust the excess service tax so paid by him (calculated on a pro rata basis) against his service tax liability for the subsequent period.

However, for carrying out such adjustment, the assessee must have refunded the value of taxable service and the service tax thereon to the person from whom it was received.

In such cases of adjustment, the assessee is required to file the details in respect of such suo moto adjustments done by him at the time of filing the service tax returns. The return Form ST – 3 also provides for enclosure of documentary evidence for adjustment of such excess service tax paid.
- (b) In relation to taxable service provided by a goods transport agency, where the consignor or consignee of goods is-
 - (a) any factory registered under or governed by the Factories Act, 1948,
 - (b) any company formed or registered under the Companies Act, 1956,
 - (c) any corporation established by or under any law,
 - (d) any society registered under Societies Registration Act, 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 or the rules made thereunder, or
 - (g) any body corporate established, or a partnership firm registered, by or under any law.

Unit – I : Payment of Service Tax

The person liable for paying service tax is any person who pays or is liable to pay freight either himself or through his agent for the transportation of such goods by road in a goods carriage.

- (c) Section 67(1)(iii) of the Finance Act, 1994 ensures payment of service tax based on valuation even when consideration is not ascertainable. However, these provisions apply only when there is consideration. If there is no consideration i.e., in case of free service, section 67 cannot apply.

Thus, no service tax is payable when value of services is zero, as the charging section 66 provides that service tax is chargeable on the value of taxable service.

Hence if the value is zero, the tax will also be zero even though the service may be taxable. However, this principle applies only when there is really a 'free service' and not when its cost is recovered through other means.

- (d) Rule 6(1) of the Service Tax Rules, 1994 provides that service tax on the value of taxable services received shall be paid to the credit of the Central Government in the following manner:-

Assessee	Duration of payment	Due date of payment
Individual, Proprietary concern or a partnership firm	Quarterly	(i) by the 6th day of the month, if the duty is deposited electronically through internet banking; and (ii) by the 5th day of the month, in any other case, immediately following the quarter in which the payments are received, towards the value of taxable services.*
Any other Assessee	Monthly	(i) by the 6th day of the month, if the duty is deposited electronically through internet banking; and (ii) by the 5th day of the month, in any other case, immediately following the calendar month in which the payments are received, towards the value of taxable services.*

*Also, the service tax on the value of taxable services received during the month of March, or the quarter ending in March, as the case may be, shall be paid to the credit of the Central Government by the 31st day of March of the calendar year.

Question 3

Ajay Ltd. has agreed to render services to Mr. Guru. The following are the chronological events:

Particulars	Rs.
Contract for services entered into on 31.8.2006	
Advance received in September, 2006 towards all services	60,000

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Total value of services, billed in February, 2007	2,10,000
Above includes non-taxable services of	70,000
Balance amount is received in March, 2007	

When does the liability to pay service tax arise and for what amount? Contract contains clear details of services; consideration and service tax are charged separately, as mutually agreed upon.

(6 Marks) (May, 2007)

The provisions as amended by the Finance (No.2) Act, 2009 and notifications and circulars issued up to October 31, 2009 may be taken into consideration while solving this question. Hence, the facts of the question may be read accordingly.

Answer

The liability to pay service tax arises at the time of receipt of advance in September, 2009 and at the time of receipt of balance consideration in March 2010. Service tax is payable as soon as any advance is received as the taxable service includes "service to be provided" and payments received, before during or after the provision of taxable services form part of the gross amount charged for the taxable services. Further, the liability to pay service tax arises only upon the receipt of the value of taxable services and not when the bill is raised.

Advance portion

Particulars	Rs.
Advance received towards all services in September, 2009	= 60,000
Amount billed for taxable services	= 2,10,000 – 70,000 = 1,40,000
Advance received towards taxable services	= 60,000 x (1,40,000/ 2,10,000) = 40,000
Service tax @ 10% (since, service tax is charged separately)	= 40,000 x 10% = 4,000
Education cess @ 2%	= 80
Secondary and higher education cess @ 1%	= 40
Total service tax liability	= 4,120

In this case, the due date for payment of service tax will be 5th October, 2009.

Balance portion

Particulars	Rs.
Balance amount received in March 2010	= 2,10,000 – Rs.60,000

Unit – I : Payment of Service Tax

	= 1,50,000
Amount received towards taxable services	= 1,50,000 x (1,40,000/2,10,000)
	= 1,00,000
Service tax @ 10%	= 1,00,000 x 10%
	= 10,000
Education cess @ 2%	= 200
Secondary and higher education cess @ 1%	= 100
Total service tax liability	= 10,300

In this case, the due date for payment of service tax will be 31st March, 2010.

Question 4

Mr. Y, a consulting engineer raised a bill of Rs. 2,24,720 (including service tax) on his client for consulting services rendered by him in June, 2007. A partial payment of Rs. 1,68,540 was received by Mr. Y in March, 2008. Compute the service tax amount payable by Mr. Y and the due date by which service tax can be deposited.

(3 Marks) (Nov, 2008)

The provisions as amended by the Finance (No.2) Act, 2009 and notifications and circulars issued up to October 31, 2009 may be taken into consideration while solving this question. Hence, the facts of the question may be read accordingly.

Answer

The service tax is payable to the Government only when payment is received, though the service provider charges service tax in his bill as and when the service is provided.

In the given case, amount of service tax liable to be paid by Mr. Y

$$= \frac{\text{Gross Amount} \times \text{Rate of tax}}{(100 + \text{Rate of tax})}$$

$$= \frac{1,68,540 \times 10.30}{110.30} = 15,739$$

Mr. Y is required to deposit service tax of Rs.15,739 on or before 31.03.2010.

Note:

1. Service tax is payable only on the value of taxable services actually received [Rule 6 of the Service Tax Rules, 1994].
2. Rate of service tax is taken to be inclusive of 2% education cess and 1% secondary and higher education cess.

UNIT-2: FILING OF RETURNS

Question 1

Answer the following questions:-

- (a) Is e-filing of service tax return permitted? (2 Marks) (May, 2007)
- (b) Which are the documents to be submitted along with service tax return? (2 Marks) (Nov, 2007)
- (c) What are the due dates for filing of service tax returns? (2 Marks) (Nov, 2007)
- (d) Who are the persons liable to file service tax returns? (2 Marks) (May, 2008)
- (e) Whether service tax return can be furnished after the due date? (2 Marks) (June, 2009)

Answer

- (a) Yes, e-filing of service tax returns is permitted under service tax law. E-filing is a facility for the electronic filing of service tax returns by the assessee from his office, residence or any other place of choice, through the internet, by using a computer.
E-filing of returns is an assessee facilitation measure of the Department in continuation of its modernization and simplification programme. It is an alternative to the manual filing of return. This facility is available to all service providers.
- (b) Along with service tax (ST-3) return, the following documents should be attached:
 - (i) copies of TR-6 challans which indicate the payment of service tax for the months/quarter covered in the half-yearly return.
 - (ii) memorandum in Form ST-3A giving full details of the difference between the amount of provisional amount of tax deposited and the actual amount payable for each month. This memorandum (Form ST-3A) is to be attached only when the assessee opts for provisional payment of service tax.
- (c) The service tax return (in Form ST-3) should be filed on half yearly basis by the 25th of the month following the particular half-year. The due dates on this basis are as under:

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Half year	Due date
1 st April to 30 th September	25 th October
1 st October to 31 st March	25 th April

In case the due date of the filing of return i.e. either 25th October or 25th April falls on a public holiday, the assessee can file the return on the immediately succeeding working day.

- (d) Section 70 of the Finance Act, 1994, inter alia, provides that every person liable to pay service tax shall himself assess the tax due on the services provided by him and shall furnish a return to the Superintendent of Central Excise.

Sub-section (2) of section 70 stipulates that certain notified person or class of persons shall also furnish to the Superintendent of the Central Excise, a return in such form and in such manner and at such frequency as may be prescribed.

- (e) A delayed return can be furnished by paying the prescribed late fee. Section 70(1) of the Finance Act, 1994 as amended, inter alia, provides for filing of periodical return after the due date with the prescribed late fee of not more than Rs. 2,000/-.

Question 2

Answer the following:

- (a) Can service tax return be revised by a person? (3 marks) (Nov, 2008)
- (b) Ms. Amrapali, a registered service provider did not render any services during the financial year 2008-09. Whether she is required to file service tax return? (3 marks) (Nov, 2009)

Answer

- (a) An assessee can submit a revised return, in Form ST-3, in triplicate, to correct a mistake or omission, within a period of 90 days from the date of submission of the original return.
- (b) Every assessee shall file a half yearly return in Form ST-3. Even if there is no service provided during a half year, a Nil return has to be filed. Therefore, Ms. Amrapali is required to file a service tax return.

VAT – CONCEPTS AND GENERAL PRINCIPLES

Question 1

Answer the following questions:-

- (a) Which is the most popular and common method for computing VAT liability and at what stage is the tax imposed? (2 Marks) (May, 2007)
- (b) Is it correct to state that VAT usually increases the retail price, as the tax is payable on the first sale price? (2 Marks) (May, 2007)
- (c) Does the VAT system bring certainty to a great extent? (2 Marks) (Nov, 2007)
- (d) Can VAT be said to be non-beneficial as compared to single stage-last point system? (2 Marks) (Nov, 2007)
- (e) Briefly explain the income variant of VAT. (2 Marks) (May, 2008)
- (f) What is the demerit of VAT from the view point that it is a form of consumption tax? (2 Marks) (May, 2008)
- (g) Can we say that levy of VAT will have effect on retail price of goods? (2 Marks) (Nov, 2008)
- (h) Discuss the word "transparency" in the context of VAT system. (2 Marks) (June, 2009)

Answer

- (a) Invoice method is the most common and popular method for computing the tax liability under the VAT system. Under this method, tax is imposed at each and every stage of sales on the entire sale value, and the tax paid at the earlier stage is allowed as set-off.
- (b) The statement is not correct as VAT is a multi-point tax where tax is imposed at each and every stage of sales and tax paid at the earlier stage is allowed as set-off.
- (c) The VAT is a system based simply on transactions. Thus there is no need to go through complicated definitions like sales, sales price, turnover of purchases and turnover of sales. The tax is also broad-based and applicable to all sales in business

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leaving little room for different interpretations. Thus, this system brings certainty to a great extent.

- (d) VAT system has many advantages like no tax evasion, transparency, certainty, reduction in cascading effect of taxes etc. However, since the VAT is imposed or paid at various stages and not at last stage, it increases the working capital requirements and the interest burden on the same. In this way, it may be considered to be non-beneficial as compared to the single stage-last point taxation system though to a certain extent, this rigour can be brought down through input credits on purchases.
- (e) The income variant of VAT allows for deductions of purchases of raw materials and components as well as depreciation on capital goods. This method provided incentives to classify purchases as current expenditure to claim set-off. In practice, however, there are many difficulties connected with the specification of any method of measuring depreciation, which basically depends on the life of an asset as well as on the rate of inflation.
- (f) VAT is a form of consumption tax. Since the proportion of income spent on consumption is larger for the poor than for the rich, VAT tends to be regressive.

However, this weakness is inherent in all the forms of consumption tax. While it may be possible to moderate the distribution impact of VAT by taxing necessities at a lower rate, it is always advisable to moderate the distribution considerations through other programmes rather than concessions or exemptions, which create complications for administration.
- (g) A persistent criticism of the VAT form has been that since the tax is payable on the final sale price, the VAT usually increases the prices of the goods. However, VAT does not have any inflationary impact as it merely replaces the existing equal sales tax. It may also be pointed out that with the introduction of VAT, the tax impact on raw material is to be totally eliminated. Therefore, there may not be any increase in the prices.
- (h) Out of total consideration paid for purchase of material, the buyer knows the tax component under a VAT system. Thus, the system ensures transparency. This transparency enables the State Government to know as to what is the exact amount of tax coming at each stage. Thus, it is a great aid to the Government while taking decisions with regards to rate of tax etc.

Question 2

Answer the following:

- (a) Briefly explain the invoice method of computing tax liability under the VAT system. What are its other names? (3 Marks) (Nov, 2007)
- (b) What are the different variants of VAT and how is deduction available for tax paid on inputs including capital inputs? (3 Marks) (Nov, 2007)

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- (c) What are the different stages of VAT? Can it be said that the entire burden falls on the final consumer? (3 Marks) (May, 2008)
- (d) Briefly explain how VAT helps in checking tax evasion and in achieving neutrality. (3 Marks) (May, 2008)
- (e) How can an auditor play a role to ensure that the tax payers discharge their tax liability properly under the VAT system? (3 Marks) (June, 2009)
- (f) Discuss the 'subtraction method' for computation of VAT. (3 Marks) (June, 2009)
- (g) VAT would increase the working capital requirements and the interest burden. Discuss (3 Marks) (Nov, 2009)

Answer

- (a) Invoice method is the most common and popular method for computing the tax liability under 'VAT' system. Under this method, tax is imposed at each stage of sales on the entire sale value and the tax paid at the earlier stage is allowed as set-off. In other words, out of tax so calculated, tax paid at the earlier stage i.e., at the stage of purchases is set-off, and at every stage the differential tax is being paid. The most important aspect of this method is that at each stage, tax is to be charged separately in the invoice. This method is very popular in western countries. In India also, under the VAT law as introduced in several States and Central Excise Law, this method is followed.
This method is also called the 'Tax Credit Method' or 'Voucher Method'.
- (b) There are three variants of VAT viz, gross product variant, income variant and consumption variant.
Gross Product Variant: Under this variant, deduction is allowed for tax paid on all inputs excluding capital inputs.
Income Variant: Under this variant, tax paid on non-capital inputs and depreciation on capital inputs is allowed.
Consumption variant: Under this variant, deduction is allowed for tax paid on all business inputs including capital inputs.
- (c) The Value Added Tax (VAT) is a multistage tax levied as a proportion of the value added (i.e. sale minus purchase) which is equivalent to wages plus interest, other costs and profits.
In an economy, apart from the manufacturers and final consumers, there would be wholesalers and retailers also. The wholesaler might supply to retailer, and each one of them could supply to the manufacturer and the end consumer. VAT will be collected at each stage, and wherever applicable, the manufacturer or retailer will claim input credit.
Thus, VAT is collected at each stage of production and distribution process, and in principle, its entire burden falls on the final consumer, who does not get any tax credit. Thus VAT is a broad-based tax covering the value added to each commodity by parties during the various stages of production and distribution.

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- (d) It is said that VAT is a logical beauty. Under VAT, credit of duty paid is allowed against the liability on the final product manufactured or sold. Therefore, unless proper records are kept in respect of various inputs, it is not possible to claim credit. Hence, suppression of purchases or production will be difficult because it will lead to loss of revenue. A perfect system of VAT will be a perfect chain where tax evasion is difficult.

Further, the greatest advantage of the system is that it does not interfere in the choice of decision for purchases. This is because the system has anti-cascading effect. How much value is added and at what stage it is added in the system of production/distribution is of no consequence. The system is neutral with regard to choice of production technique, as well as business organisation. All other things remaining the same, the issue of tax liability does not vary the decision about the source of purchase. VAT facilitates precise identification and rebate of the tax on purchases and thus ensures that there is no cascading effect of tax. In short, the allocation of resources is left to be decided by the free play of market forces and competition.

- (e) Under the VAT system, trust has been reposed on tax payers, as there will be no regular assessment of all VAT returns, but only a few VAT returns will be taken up for scrutiny assessment. In other cases, the return filed by the trader will be accepted. It will not be also seen whether proper records have been maintained by the trader.

As a consequence, a check on compliance becomes essential. Chartered Accountants can ensure tax compliance by:-

- (i) helping the client in systematic record keeping;
 - (ii) helping the client in interpretation of the provisions of VAT law, and
 - (iii) performing audit of VAT accounts.
 - (iv) reporting the under-assessment, if any, made by the dealer requiring additional payment or
 - (v) reporting any excess payment of tax warranting refund to the tax payers.
- (f) Under the subtraction method, the tax is charged only on the value added at each stage of the sale of the goods. Since, the total value of goods sold is not taken into account, the question of grant of claim for set-off or tax credit does not arise.

This method is normally applied where the tax is not charged separately. Under this method for imposing tax, 'value added' is simply taken as the difference between sales and purchases.

- (g) One of the demerits of VAT is that it increases the working capital requirements and the interest burden. The tax is imposed or paid at various stages and not on last stage only. It increases the requirement of working capital and also the interest element as compared to single stage-last point taxation system.

Question 3

Compute the invoice value to be charged and amount of tax payable under VAT by a dealer who had purchased goods for Rs. 1,20,000 and after adding for expenses of Rs.

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10,000 and of profit Rs. 15,000 had sold out the same.

The rate of VAT on purchases and sales is 12.5%. (3 Marks) (Nov, 2007)

Answer

Computation of invoice value:-

Particulars	Rs.	Rs.
Cost of goods purchased		1,20,000
Add: Expenses	10,000	
Profit margin	15,000	25,000
Product Sale Value		1,45,000
Add: VAT @ 12.5%		18,125
Invoice Value		<u>1,63,125</u>
Computation of amount of tax payable under VAT		
VAT charged on sales		18,125
Less: Input credit of VAT paid on purchases @ 12.5% on 1,20,000		15,000
Tax Payable under VAT		<u>3,125</u>

Note: It has been assumed that the purchase price of Rs. 1,20,000 is exclusive of VAT.

Question 4

Compute the VAT amount payable by Mr. A who purchases goods from a manufacturer on payment of Rs. 2,25,000 (including VAT) and earns 10% profit on sale to retailers. VAT rate on purchase and sale is 12.5%. (3 Marks) (June, 2009)

Answer

Computation of VAT payable by Mr. A:-

	Amount (Rs.)
Payment made to manufacturer	2,25,000
Less: VAT paid $(2,25,000 \times 12.5)/112.5$	<u>25,000</u>
Purchase price	2,00,000
Add: Profit margin (10% of Cost Price)	20,000
Sale price before VAT	<u>2,20,000</u>
Add: VAT @ 12.5% on Rs. 2,20,000	27,500
Invoice value after 10% profit margin	<u>2,47,500</u>
VAT charged in invoice	27,500
Less: VAT input credit $(2,25,000 \times 12.5)/112.5$	<u>25,000</u>
VAT payable by Mr. A	<u>2,500</u>

Taxation

Note: Profit has been computed as 10% of the cost price of the goods.

Question 5

Mr. Goenka is a trader selling raw materials to a manufacturer of finished products. He imports his stock in trade as well as purchases the same from the local markets. Following transaction took place during financial year 2008-09:-

Calculate the VAT and invoice value charged by him to a manufacturer. Assume the rate of VAT @ 12.50%:

	Rs.
(1) Cost of imported materials (from other State) excluding tax	1,00,000
(2) Cost of local materials including VAT	2,25,000
(3) Other expenditure including storage, transport, interest and loading and unloading and profit earned by him	87,500

(5 Marks) (Nov, 2009)

The facts of the question may be taken to be that of the financial year 2009-10

Answer

Sales Price of goods:-

Particulars	Rs.
Imported material cost	1,00,000
	12,500
[Since, this is not a VAT levied inside the State, it will form part of cost of input]	
Add: Cost of local materials	2,25,000
Less: VAT @12.5%	<u>25,000</u> 2,00,000
[Since, credit of Rs. 25,000 would be available, it will not be included in cost of input]	
Add: Other expenses and profit	<u>87,500</u>
Sales Price of goods	4,00,000
Add: VAT on the above @12.5%	<u>50,000</u>
Invoice value charged by Mr. Goenka to the manufacturer	<u>4,50,000</u>

VAT charged by Mr. Goenka is Rs. 50,000.