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# **DIVISION - I**



## CHAPTER 1

# Basic Concepts of Indirect Taxes

### Learning Objectives

- ✓ Understanding the concept of taxation
- ✓ Understanding the concept of direct tax and indirect tax and the differences between the two
- ✓ Highlighting the basic features of indirect taxes
- ✓ Understanding the constitutional provisions relating to levy and collection of taxes
- ✓ Understanding the principal indirect taxes
- ✓ Understanding the basic administrative set-up of indirect taxes
- ✓ Knowing the role of Chartered Accountant in indirect taxes

### Introduction

Taxes are collected by the Government to fulfill the socio-economic objectives of the Government. Collection of tax by the Government is primarily to provide public services. It has also been used as an instrument of fiscal policy to stimulate economic growth. India, being a developing economy, has been striving to fulfill the obligations of increasing the developmental needs of the country and its people by way of public expenditure, with its limited resources; the primary source of revenue being the levy of taxes.

A tax is a pecuniary burden laid upon individuals or property owners to support the Government, a payment exacted by legislative authority. A tax is not a voluntary payment or donation, but is a compulsory exaction of money by the Government, exacted pursuant to legislative authority. In simple words, tax is nothing but the money that people have to pay to the Government, which is primarily meant to be used to provide public services.

### Direct Taxes & Indirect Taxes

Taxes are broadly classified into direct and indirect taxes.

#### 1. Direct Taxes

A direct tax is one imposed directly on the taxpayer and paid directly to the government by the persons (juristic or natural) on whom it is imposed. The burden of direct tax cannot be shifted by the taxpayer to someone else. It is evident that direct taxes are imposed on persons (juristic or natural). Direct taxes are progressive in nature, which implies that they are based on the principle of ability to pay. It implies that higher rate of taxes for those people having

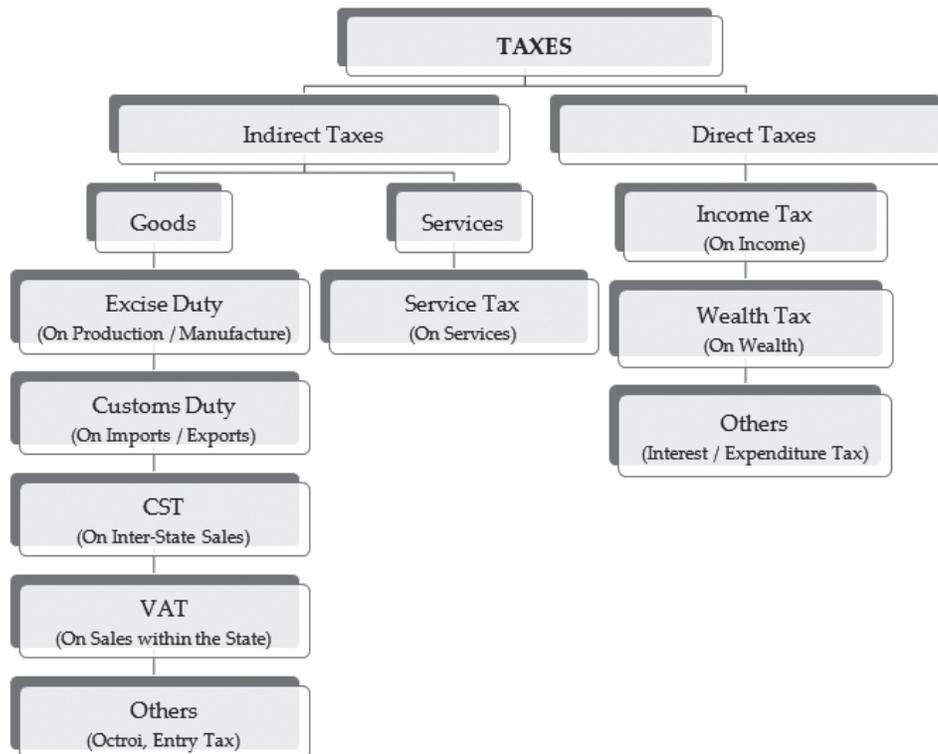
higher ability to pay and lower rates of taxes for those who have lesser ability to pay. Examples of direct taxes in India are income tax and wealth tax.

## 2. Indirect Taxes

An indirect tax is one whose incidence is borne by the consumers who ultimately consumes the product or the service, while the immediate liability to pay the tax may fall upon another person such as manufacturer of goods or seller of goods or provider of services. The burden of indirect tax can be shifted by the taxpayer to someone else. It is evident that indirect taxes are imposed on goods and services. Indirect taxes are regressive in nature, which implies that they are not based on the principle of ability to pay. It implies that all the consumers, including the economically challenged bear the burden of the indirect taxes equally. Examples of indirect taxes in India are excise duty, customs duty, service tax, central sales tax (CST), value added tax (VAT), purchase tax, entry tax and octroi.

Direct Taxes	Indirect Taxes
Direct taxes are levied on persons	Indirect taxes are levied on goods and services
Tax incidence is borne by the same person who pays it	Tax incidence passes on to the ultimate consumers
Direct taxes are progressive in nature. Thus, the more the income or wealth of a person, the more the direct tax on that person	Indirect taxes are regressive in nature. However, the effect of regression can be reduced by not taxing essential commodities

The different types of direct taxes and indirect taxes are presented below:



## Features of Indirect Taxes

The following are the key features of indirect taxes:

- a. **Tax on goods and services:** Indirect taxes are levied on goods / commodities at the time of manufacture or purchase or sale or import or export thereof. They are also levied on provision of services.
- b. **Important source of revenue:** Indirect taxes are a major source of tax revenues for Governments worldwide and continue to grow as more countries are moving to consumption-oriented tax regimes. In India, indirect taxes contribute more than 50% of the total tax revenues of Central Government and more for the State Governments.
- c. **Wider tax base:** Unlike direct taxes, the indirect taxes have a wider tax base. Majority of the products or services are subject to indirect taxes with low thresholds.
- d. **Shifting of tax burden:** In respect of indirect taxes, there is a shifting of tax burden. For example, VAT which is paid by the seller of the goods is recovered from the buyer by including the tax in the price of the commodity.
- e. **No perception of direct pinch:** Since the value of the indirect taxes is generally inbuilt in the price of the commodity, most of the time the buyer of goods or the recipient of services pays the same to the seller of goods or the provider of services without actually knowing that he is indirectly paying the taxes to the Government through the seller of goods or the provider of service. Thus, the buyer of goods or the recipient of services does not perceive a direct pinch while paying indirect taxes.
- f. **Inflationary:** Tax imposed on goods and the services causes an all-round price increase. It implies that increase in indirect taxes directly affects the prices of the goods and the services and leads to inflationary trend making essential goods out of the reach of the poor.
- g. **Regressive in nature:** Indirect taxes are regressive in nature. The rich and the poor have to pay the same rate of indirect taxes. This may further increase the income disparities between the rich and the poor. However, the effect of regression can be reduced by not taxing or taxing at lower rates the essential commodities.
- h. **Promotes social welfare:** High taxes are imposed on consumption of harmful products (i.e. sin goods) such as alcoholic liquor, tobacco products, etc. This not only checks their consumption but also enable the Central Government and the State Governments to collect substantial revenue.

## Constitutional Provisions

The Constitution of India is the supreme law of India. It consist of a Preamble, 22 parts containing 444 Articles and 12 Schedules. Power to levy and collect tax (direct tax or indirect tax) emerges from the Constitution of India. In case of any tax law (act, rule, notification or order) is not in conformity with the Articles of the Constitution, it is ultra-vires the Constitution and is illegal and void.

The significant provisions of the Constitution relating to taxation are:

<b>Article 265</b>	No tax shall be levied or collected except by authority of law.		
<b>Article 245</b>	The powers for enacting the law is conferred on the Parliament and on the Legislature of a State. Parliament may make laws for the whole or any part of the territory of India, and the Legislature of a State may make laws for the whole or any part of the State.		
<b>Article 246</b>	This governs the subject matter of the laws, which are made by the Parliament and by the Legislature of States. The matters are listed in the Seventh Schedule to the Constitution.		
	<b>List I – Union List</b>	<b>List II – State List</b>	<b>List III – Concurrent List</b>
	It contains the matters in respect of which the Parliament has the exclusive right to make laws. Entries 82 to 92-C of List I deals with taxation laws where the Central Government has power to levy taxes.	It contains the matters in respect of which the Legislature of State has the exclusive right to make laws. Entries 45 to 63 of List II deals with taxation laws where the State Government has power to levy taxes.	It contains the matters in respect of which both the Parliament and the Legislature of State have the powers to make laws. There is no head of taxation in List III (i.e. Union and States have no concurrent power of taxation).

The following table lists out the significant direct and indirect taxes being levied in India under the various Entries of the Union List and the State Lists.

<b>List I – Union List</b>	<b>List II – State List</b>
<b>Income Tax</b> Entry 82 – Taxes on income other than agricultural income.	<b>State Excise Duties</b> Entry 51 – Duties of excise on alcoholic liquor for human consumption, opium, Indian hemp and other narcotics drugs and narcotics. (This entry does not include duties of excise on medicinal and toilet preparations containing alcohol or opium or Indian hemp or narcotic drugs or narcotics).
<b>Customs Duties</b> Entry 83 – Duties of customs including export duties.	<b>State Level VAT</b> Entry 54 – Taxes on the sale or purchase of goods (excluding newspapers) other than tax on inter-state sale or purchase of goods (excluding newspapers).
<b>Central Excise Duties</b> Entry 84 – Duties of excise on tobacco and other goods manufactured or produced in India except alcoholic liquor for human consumption, opium, Indian hemp and other narcotics drugs and narcotics, but including medicinal and toilet preparations containing alcohol or opium or Indian hemp and other narcotic drugs or narcotics.	

<p><b>Wealth Tax</b></p> <p>Entry 86 – Taxes on capital value of assets, exclusive of agricultural land of individuals and companies; Taxes on the capital of companies.</p>	
<p><b>Central Sales Tax</b></p> <p>Entry 92-A – Taxes on sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-state trade or commerce.</p>	
<p><b>Service Tax</b></p> <p>Entry 92-C – Tax on services.</p> <p>Entry 97 – Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists. (Service tax is levied under Entry 97 as Entry 92C is not yet made effective).</p>	

### Principal Indirect Taxes

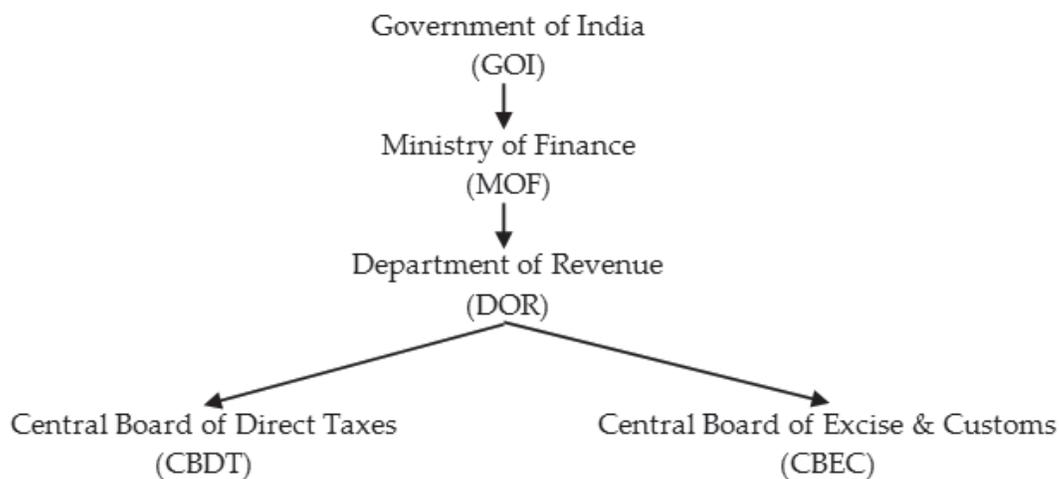
The principal central and state level indirect taxes being levied in India along with the relevant statutes are given below:

Tax / Duty	Statute	Particulars
Excise Duty	Central Excise Act, 1944 Central Excise Tariff Act, 1985	A tax imposed by the Central Government on the manufacture or production of goods in India. <i>Basic General Rate: 12%</i>
Customs Duty	Customs Act, 1962 Customs Tariff Act, 1975	A duty imposed by the Central Government on the goods imported in India or exported out of India. <i>Basic General Rate: 10% + Additional duty of customs (Countervailing Duty for Excise Duty – CVD): 12% + Special additional duty of customs (Special Countervailing Duty for Sales Tax – Special CVD): 4%</i>
Service Tax	Chapter V and V-A of the Finance Act, 1994	A tax imposed by the Central Government on the service provided or agreed to be provided in India. <i>Rate: 12%</i>
Central Sales Tax	Central Sale Tax Act, 1956	A tax imposed by the Central Government but collected by the Originating State on the inter-state sales of goods. <i>Rate: 2%</i>
Value Added Tax	VAT Acts of respective State Governments	A tax imposed by the State Governments on the intra-state sales of goods. <i>Basic General Rate: 5% and 12.5%/ 13.5%/ 14.5%</i>

Besides these, there are other indirect taxes like entry tax, luxury tax, entertainment tax, etc. levied by the State Governments. Municipal or local authorities also impose taxes like octroi, local area taxes, local body taxes.

### Administration of Indirect Taxes

The Department of Revenue of the Ministry of Finance of the Government of India exercises control in respect of matters relating to all the direct and indirect taxes levied and collected by the Central Government through 2 statutory Boards namely the Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC) respectively. These 2 Boards are constituted under the Central Board of Revenue Act, 1963. Matters relating to the levy and collection of all the direct taxes are looked after by CBDT and matters relating to levy and collection of all the indirect taxes are under the purview of CBEC.



The indirect taxes levied and collected by the Central Government are administered by CBEC whereas the indirect taxes levied and collected by the State Governments are administered by Commercial Tax Departments of the respective States.

### Role of Chartered Accountant in Indirect Taxes

Some of the areas where services of Chartered Accountant (CA) are essential in indirect taxation are as under:

- a. **Procedural Compliances:** CAs can facilitate compliance of basic procedural aspects of indirect tax laws such as getting registration, making payment of taxes or duties and filing of returns.
- b. **Advisory Services:** CAs can provide advisory services including giving legal opinions for complex issues and tax planning for big projects.
- c. **Audit & Review Services:** CAs can do periodic review and audit of customs duty / excise duty / service tax. CAs can also do pre-audit review prior to departmental audit / CAG audit.

- d. **Representation Services:** CAs can draft reply to show cause notice (SCN) issued by the Department and represent before the Department, Commissioner (Appeals) and Tribunal as authorized representative for the assessee.
- e. **Assistance:** CAs can provide assistance (including certification of relevant documents) to the assessee to get the refunds of customs duty / excise duty / service tax. CAs can also provide assistance to advocates at the High Court / the Supreme Court.
- f. **Continuous Updation:** CAs are well capable of understanding the effect of budget / recent changes on activities carried out by the assessee. Thus, they can keep the client updated with the latest developments.
- g. **Others Areas:** CAs also play an important role in other areas such as training, teaching, writing articles, etc.

### Self Examination Questions

1. What do you mean by tax? Differentiate direct tax and indirect tax.
2. What are the key features of indirect taxes?
3. Explain the administrative set-up of indirect taxes.
4. What is the role of a Chartered Accountant in indirect taxes?

## Short Revision Notes

<b>Direct Taxes and Indirect Taxes</b>	<b>Direct Taxes</b>			
	Direct taxes are levied on persons			
	Tax incidence is borne by the same person who pays it			
	Direct taxes are progressive in nature. Thus, the more the income or wealth of a person, the more the direct tax on that person			
Examples of direct taxes are income tax, wealth tax, etc.				
<b>Features of Indirect Taxes</b>			<b>Indirect Taxes</b>	
	Indirect taxes are levied on goods and services		Indirect taxes are levied on goods and services	
	Tax incidence is borne by the same person who pays it		Tax incidence passes on to the ultimate consumers	
	Direct taxes are progressive in nature. Thus, the more the income or wealth of a person, the more the direct tax on that person		Indirect taxes are regressive in nature. However, the effect of regression can be reduced by not taxing essential commodities	
Examples of direct taxes are income tax, wealth tax, etc.		Examples of indirect taxes are excise duty, customs duty, service tax, VAT, etc.		
<b>Constitutional Provisions</b>	<p>a. Tax on goods and services</p> <p>b. Important source of revenue</p> <p>c. Wider tax base</p> <p>d. Shifting of tax burden</p>		<p>e. No perception of direct pinch</p> <p>f. Inflationary</p> <p>g. Regressive in nature</p> <p>h. Promotes social welfare</p>	
	The significant provisions of the Constitution relating to taxation are:			
	<b>Article 265</b>	No tax shall be levied or collected except by authority of law.		
	<b>Article 245</b>	The powers for enacting the law is conferred on the Parliament and on the Legislature of a State.		
<b>Article 246</b>	This governs the subject matter of the laws, which are made by the Parliament and by the Legislature of States. The matters are listed in the VII Schedule to the Constitution.			
<b>List I</b>		<b>List II</b>	<b>List III</b>	
<b>Union List</b>		<b>State List</b>	<b>Concurrent List</b>	
It contains the matters in respect of which the Parliament has the exclusive right to make laws.		It contains the matters in respect of which the Legislature of State has the exclusive right to make laws.	It contains the matters in respect of which both the Parliament and the Legislature of State have the powers to make laws.	

<b>Principal Indirect Taxes</b>	<b>Excise Duty</b>	A tax imposed by the Central Government on the manufacture or production of goods in India. <i>Basic General Rate: 12%</i>
	<b>Customs Duty</b>	A duty imposed by the Central Government on the goods imported in India or exported out of India. <i>Basic General Rate: 10% + CVD: 12% + Special CVD: 4%</i>
	<b>Service Tax</b>	A tax imposed by the Central Government on the service provided or agreed to be provided in India. <i>Rate: 12%</i>
	<b>Central Sales Tax</b>	A tax imposed by the Central Government but collected by the Originating State on the inter-state sales of goods. <i>Rate: 2%</i>
	<b>Value Added Tax</b>	A tax imposed by the State Governments on the intra-state sales of goods. <i>Basic General Rate: 5% and 12.5%/ 13.5%/ 14.5%</i>

**Administration of Indirect Taxes**

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    graph TD
      GOI[Government of India (GOI)] --> MOF[Ministry of Finance (MOF)]
      MOF --> DOR[Department of Revenue (DOR)]
      DOR --> CBDT[Central Board of Direct Taxes (CBDT)]
      DOR --> CBEC[Central Board of Excise and Customs (CBEC)]
    
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The indirect taxes levied and collected by the Central Government are administered by CBEC whereas the indirect taxes levied and collected by the State Governments are administered by Commercial Tax Departments of the respective States.

<b>Role of Chartered Accountants in Indirect Taxes</b>	<ul style="list-style-type: none"> <li>a. Procedural Compliances</li> <li>b. Advisory Services</li> <li>c. Audit &amp; Review Services</li> <li>g. Other Ares – Training, Teaching, Writing Articles, etc.</li> </ul>	<ul style="list-style-type: none"> <li>d. Representation Services</li> <li>e. Assistance</li> <li>f. Continuous Update</li> </ul>
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