CMA Students Newsletter (For Intermediate Students)

Vol.9B: May 15, 2015

INTER-DEPARTMENTAL TRANSFERS

Basis of Inter-Departmental Transfers:
The Goods or Services may be transferred by one department to another department on either of the following basis:
(i) At Actual Cost (ii) At Cost plus agreed percentage of profit, (iii) At Ruling Market Price, The transfer by transferor department is treated as sales and as purchases by transferee department.

Elimination of Unrealized Profit:
When the transfer price includes an element of profit, the unrealized profit included in the unsold stock at the end of the year is to be excluded so as to eliminate an anticipated profit included therein. Such unrealized profit is eliminated by creating a Stock Reserve.

How to calculate Stock Reserve: The amount of Stock Reserve is calculated as follows:
Step 1: Treat the Transfer of Goods as Sales of the Transferor Deptt and as Purchases of the Transferee Deptt.
Step 2: Treat the Return of Goods as Purchase Returns of the Returning Deptt and as Sales Returns of the Receiving Deptt.
Step 3: Show All Direct Expenses in the Individual Trading Account of each Deptt
Step 4: Calculate the Gross Profit of each Deptt
Step 5: Calculate the Net Sales (i.e. Sales + Internal Transfers - Sales Returns) of each Deptt.
Step 6: Calculate the Stock Reserve (i.e. Unrealised Profit included in Closing Stock of each Deptt)

$$= \text{Transfer Price of unsold Stock of Transferee Deptt} \times \frac{\text{Gross Profit of Transferor Deptt.}}{\text{Net Sales of Transferor Deptt.}}$$

Journal Entry:
The following Journal entry is passed in this regard:
Profit and Loss A/c Dr.
To Stock Reserve A/c
(Being the provision made for unrealized profit included in closing stock)

1.

X Ltd. has two departments A and B. from the following particulars, prepare the Departmental Trading Account and Consolidated Trading & Profit & Loss Account of the year ending on 31st March, 2014:

	A (₹)	B (₹)
Opening Stock (at cost)	20,000	12,000
Purchases	92,000	68,000
Sales	1,40,000	1,12,000
Wages	12,000	8,000
Carriage	2,000	2,000
Closing Stock:		
(i) Purchased goods	4,500	6,000
(ii) Finished goods	24,000	14,000
Purchased goods transferred:		
By B to A	10,000	
By A to B		8,000
Finished goods transferred:		
By A to B	35,000	
By B to A		40,000
Return of finished goods:		
By A to B	10,000	
By B to A		7,000

You are informed that purchased goods have been transferred mutually at their respective departmental purchase cost and finished goods at departmental market price and that 20% of the finished stock (closing) at each department represented finished goods received from the other department.

Solution:

Departmental Trading Account
For the year ending on 31st March, 2013

Dr. **Cr.**

Particulars	Dept. A (₹)	Dept. B (₹)	Particulars	Dept. A (₹)	Dept. B (₹)
To Stock	20,000	12,000	By Sales	1,40,000	1,12,000
To Purchase	92,000	92,000	By Purchased Goods t/f to other Dept.	8,000	10,000
To Wages	12,000	12,000	By Finished Goods t/f to other Dept.	35,000	40,000
To Carriage	2,000	2,000	By Return of Finished Goods to other Dept.	10,000	7,000
To Purchased Goods from other Dept.	10,000	8,000	By Closing Stock:		
To Finished Goods t/f from other Dept.	40,000	35,000	- Purchase Goods	4,500	6,000
ToReturn of Finished goods from other Department	7,000	10,000	- Finished Goods Out of t/f	4,800	2,800
To Gross Profit	38,500	46,000	- Balance	19,200	11,200
	2,21,500	**1,89,000**		**2,21,500**	**1,89,000**

Consolidated Trading and Profit & Loss Account
For the year ending on 31st March, 2013

Dr. **Cr.**

Particulars	(₹)	Particulars	(₹)
To Opening Stock	32,000	By Sales	2,52,000
To Purchases	1,60,000	By Closing Stock:	
To Wages	20,000	Purchased Goods	10,500
To Carriage	4,000	Finished Goods	38,000

To Gross Profit c/d	84,500		
	3,00,500		**3,00,500**
To Stock Reserve	2,197	By Gross Profit b/d	84,500
To Net Profit	82,303		
	84,500		**84,500**

Working Notes:

(i) Calculation of Net Sales (including transfers)

		Dept. A (₹)	Dept. B (₹)
(a)	Sales	1,40,000	1,12,000
(b)	Add: Transfer	35,000	40,000
(c)	Less: Returns	7,000	10,000
(d)	Net Sales plus Transfer	1,68,000	1,42,000

(ii) Unrealized Profit on Closing Stock: Dept. A 4,800 × 46,000/1,42,000 = ₹ 1,555
Dept. B 2,800 × 38,500/1,68,000 = ₹ 642

2.

A company has two departments A and B. Department A sells goods to department B at normal market price. From the following particulars, prepare a departmental trading and profit and loss account for the year ended 31st March, 2014:

Particulars	**Deptt. A ₹**	**Deptt. B ₹**	**General Total ₹**
Opening Stock	**15,000**	**Nil**	
Purchases	**2,50,000**	**40,000**	
Goods from department A	**-**	**40,000**	
Wages	**15,000**	**20,000**	
Salaries (departmental)	**7,000**	**5,000**	
Closing stock at cost to the department	**80,000**	**20,000**	
Sales	**2,60,000**	**1,45,000**	
Printing and stationery	**2,500**	**1,500**	
Machinery	**-**	**15,000**	
Advertisement	**-**	**-**	**12,000**
Salaries (general)	**-**	**-**	**18,000**

Depreciate machinery by 10%. The general unallocated expenses are to be apportioned ratio of 2: 1 to the departments A and B. Half of the closing stock of department B represents goods received from department A.

Solution:

Departmental Trading and Profit and Loss Account
For the year ended 31st march, 2011

Dr. **Cr.**

	Deptt. A ₹	**Deptt. B ₹**	**Total ₹**		**Deptt. A ₹**	**Deptt. B ₹**	**Total ₹**
To Opening Stock	15,000	-	15,000	By Sales	2,60,000	1,45,000	4,05,000
To Purchases	2,50,000	40,000	2,90,000	By Department B (transfer of Goods)	40,000	-	-
To Department A (transfer of goods)	-	40,000	-	To Closing stock	80,000	20,000	1,00,000

To Wages	15,000	20,000	35,000				
To Gross Profit c/d	1,00,000	65,000	1,65,000				
	3,80,000	**1,65,000**	**5,05,000**		**3,80,000**	**1,65,000**	**5,05,000**
To Salaries	19,000	11,000	30,000	By Gross profit b/d	1,00,000	65,000	1,65,000
To Printing and Stationery	2,500	1,500	4,000				
To Advertisement	8,000	4,000	12,000				
To Depreciation on machinery	-	1,500	1,500				
To Departmental profit c/d	70,500	47,000	1,17,500				
	1,00,000	65,000	1,65,000		1,00,000	65,000	1,65,000
To Provision for unrealized profit on stock			3,333	By Departmental profit b/d			1,17,500
To Net Profit			1,14,167				
			1,17,500				**1,17,500**

Working Notes:

	Deptt. A	**Deptt. B**
(1) Salaries	₹	₹
Departmental	7,000	5,000
General (2 : 1)	12,000	6,000
	19,000	11,000

(2) Provision for unrealized profit on stock:

Rate of gross profit in A department: $\frac{\text{₹}1,00,000}{\text{₹}3,00,000} \times 100 = 33\ 1/3\ \%$

Goods from A department in the stock of B department = ½ × ₹ 20,000 =₹10,000.
Unrealized profit = 33 1/3% of ₹10,000 = ₹3,333.

(A) Income Tax Act, 1961

Basic Concepts and Definitions

(1) Assessee [Section 2(7)]

Assessee means a person by whom any tax or any other sum of money is payable under this Act and includes :

(a) Every person in respect of whom any proceeding under the Income Tax Act has been taken:
  - (i) for the assessment of his income or the income of any other person in respect of which he is assessable.
  - (ii) to determine the loss sustained by him or by such other person.
  - (iii) to determine the amount of refund due to him or to such other person.

(b) Every person who is deemed to be an assessee under any provision of this Act, e.g. legal heirs or legal representative of a deceased person or the agent of non-resident or the trustee of a trust.

(c) Every person who is deemed to be an assessee in default under any provisions of this Act.
For example: a person or institution who fails to deduct tax at source before payment or after deduction of tax fails to deposit the same in the Government Treasury within the specified time.

(2) Person [Section 2(31)]

According to Section 2(31), the term 'person' in income tax Act includes

(i) An Individual;
(ii) A Hindu Undivided Family (HUF);
(iii) A Company;
(iv) A Firm;
(v) An Association of Persons (AOP) or a Body of Individuals (BOI), whether incorporated or not;

(vi) A Local authority;
(vii) Every artificial juridical person not falling within any of the preceding subclauses.

Explanation of Different Classes of Person

(a) Individual

An individual means a natural person, i.e. a human being who may be a male, female, minor child and a lunatic. The income of a minor is included in the income of parent. The assessment of minor or lunatic whose income is taxable is done in accordance with the provisions of Section 160; i.e. through representative assessee.

(b) Hindu Undivided Family (HUF)

Hindu undivided family has not been defined under the Act. However, as per Hindu law, it means a family which consists of all persons lineally descended from a common ancestor including their wives and unmarried daughters.

(c) Association of Persons (AOP)

An association of persons means two or more persons joining for a common purpose or common action. An AOP may comprise two or more individuals or non-individuals like firm, HUF, company, etc. When they associate themselves in an income-producing activity then they become an association of persons, i.e. there must be a common design to produce income.

(d) Body of Individuals (BOI)

Body of individuals means combination of individuals who carry on some activity with the objective of earning some income. It would consist only of individuals. Non-individuals like firms, companies cannot be members of a body of individuals. As BOI pays tax on the income earned by them, no tax is payable by the members of the body of individuals on the share of income received by them.

Distinction between AOP and BOI

(i) An AOP may consist of non-individuals but a BOI is to consist of individuals only. If two or more persons like firm, company, HUF, individuals etc. join together, it is called AOP. But if only individuals join together then it is called a BOI.
(ii) In case of an AOP there must be some common will to engage in an income-producing activity, whereas a BOI may or may not have such common will.

(e) A Firm

As per Section 2(23), a firm means a partnership firm as defined under the Partnership Act, 1932. Partner shall include any person who has been admitted to the benefits of partnership.

(f) A Company

A company may be defined as an artificial person created by law having an independent legal entity with perpetual succession. A domestic company means an Indian company or any other company, which in respect of its income, is liable to tax under the Income Tax Act, and has made the prescribed arrangements for the declaration and payment within India.

(g) Foreign Company

Foreign company means a company which is not a domestic company.

(h) Local Authority

The expression Local Authority means:
(i) Panchayat,
(ii) Municipality,
(iii) Municipal Committee and District Board which are legally entitled to or entrusted by the Government for control or management of Municipal or Local Funds,
(iv) Cantonment Board.

(i) Artificial Juridical Persons

Artificial juridical persons are not natural persons, but have separate entities in the eyes of law. It covers god, idols, and deities. Though they may not be sued directly, they can be legally sued through the priests or the managing committee of the place of worship, etc.

Similarly, all other artificial persons, with a juristic personality, will also fall under this category, if they do not fall within any of the preceding categories of persons. For example University, Bar Council, etc. will fall under this category.

(3) Previous Year U/S(3)

Previous year is the income year in which year the assessee will generate his/her income. Previous year is the financial year which started from 1st April and ended on 31st March of the next year. Previous year is just preceding year of the assessment year. As for example, if assessment year is 2012-2013, previous year will be 2011-2012. When assessment year is 2011-2012 then previous year is 2010-2011 and so on.

So, previous year is a period of 12 months. But it has some exceptions when previous year will be less than 12 months. Following are the examples :

(1) When a new establishment started at the middle of the year.
(2) An employee joined in any service at the middle of the year.
(3) Any source of income arises newly on any date during the previous year.

For the above cases, previous year will start from the date of starting of income and end on 31st March of the next year.

One previous year may become the same assessment year in the following cases :

(1) For income of a non-resident from any shipping business.
(2) If an assessee leaves India having no chance to return back.
(3) Assessment of persons likely to transfer property to avoid tax.
(4) Where any business or profession is discontinued in any year.
(5) Assessment of association of persons or body of individuals or artificial juridical person formed for a particular event or purpose.

(4) Assessment Year U/S 2(9)

According to Section 2(9) of the Income Tax Act, 1961, assessment year is the period of 12 months, it is the financial year which starts on 1st April and ends on 31st March of the next calendar year. As for example, if previous year is 2011-2012, then assessment year is 2012-2013 and so on.

The income of a person is assessed in the assessment year and tax is paid on such assessed income. Assessment year will always be for 12 months. A single assessment year and multiple previous years is not possible.

(5) Heads of Income

According to Section 14 of Income Tax Act, 1961, there are five definite and specific heads of Income :

(1) Income from salary **[Sections 15—17]**
(2) Income from house property **[Sections 22—27]**
(3) Profits and gains of business or profession **[Sections 28—44]**
(4) Income from capital gains **[Sections 45—55]**
(5) Income from other sources **[Sections 56—59]**

(6) Gross Total Income and Taxable Income

For the purpose of assessment, the income of an assessee has been classified under five heads of income according to Section 14 of the Income Tax Act:

(1) Income from salary.
(2) Income from house property.
(3) Profits and gains of business.
(4) Income from capital gains.
(5) Income from other sources.

Gross total income is the summation of the above-mentioned five heads of income before allowing any deduction under Chapter VIA. The gross total income should be adjusted by the current year losses and carry forward losses according to Sections 71—79.

Whereas taxable income is the total income which is to be computed by deducting deduction of Chapter VIA u/s 80C to 80U.

Assessee will not pay tax separately on individual heads of income—rather he will pay tax on total income at the rates prescribed by the Finance Act for the relevant year.

An assessee may have some income on which tax is to be imposed at special rates. As for example : Long-term Capital Gains and income from lotteries etc.

A specimen of computation of total income is given:

Particulars	₹	₹
(i) Salaries [as per Sections 15—17]	* * *	
(ii) Income from house property [computed as per Sections 22—27]	* * *	
(iii) Profits and gains of business and profession [computed as per Sections 28—44]	* * *	
(iv) Capital gains [computed as per Sections 45—55]	* * *	
(v) Income from other sources [computed as per Sections 56—59]	* * *	* * *
Less: Adjustment on A/c of set-off and carry forward of losses		
Gross Total Income		* *
		* * *
Deduction u/s 80C to 80U		* *
Total Income		* * *

Income Tax is one Tax

Income Tax is imposed on Total Income by aggregating the incomes assessed under separate heads. From that Gross Total Income some deductions as allowed under chapter VIA are made. The Income Tax is usually calculated on total income calculated as above, thus Income Tax is known as one Tax.

But in the present situation this statement is not extremely valid. Certain sections of the Income Tax act like Sections 112,113,115,164,167 etc. provide separate rate of Taxation in some special cases. Again, Income from Long-term Capital Gain, Income from lotteries etc. are taken at separate rates. In that case Income Tax does not remain one tax wholly.

(8) Tax Evasion

It is an improper and an unlawful way of deducting own tax liability by a tax payer. By suppression of incomes, showing inflated and unreal expenses, claiming set-off of fictitious losses etc. a dishonest tax payer can reduce his tax-liability. It is an illegal way and criminal offence. If it is detected, fines and penalties may be imposed.

(9) Tax Avoidance

Tax avoidance is an attempt to avoid tax or to pay less income tax by taking advantages of the loopholes in the income tax laws. The tax payer utilises the twisting language or facts of the tax laws to avoid tax-burden. It is not punishable, but it is immoral.

(10) Tax Planning

Tax planning is the process of application of knowledge, about tax laws in advance to reduce the tax-liability of the assessee. It utilises the benefit of exemptions, rebates, deductions and reliefs provided in the Income Tax Act and rules. It is relating to the assessment of tax in a notional way for its future payment. It is a healthy practice.

(11) Distinction between Tax Evasion and Tax Avoidance

Tax evasion is an unlawful or improper way of paying less Income Tax. Suppresion of income and/or showing of inflated and unreal expense etc. are the improper ways.

Tax Avoidance means use of shortcomings and loopholes or weaknesses in the rules or laws of Income Tax by the assessee.

Following are the distinctions between Tax Evasion and Tax Avoidance:

Tax Evasion	Tax Avoidance
(a) It is an unlawful way and dishonest means to pay less Income Tax.	(a) It is a lawful way, adopted by taking ad vantages of the loop-holes in the rules and laws related to Income Tax to pay less Income Tax.
(b) Tax Evasion leads to suppression of in come, overstatement of expenses etc.	(b) It is an attempt to enjoy Tax relief or benefit on income which is otherwise liable to be assessed.
(c) Tax Evasion is caused by mal-practice, fraud and falsification.	(c) Tax Avoidance is caused by availing of Tax exemption and Tax privileges.

Tax Evasion and Tax Avoidance both are to avoid Tax and both are social crime.

(12) Income

As per definition of Income u/s 2(24) it is inclusive but not exhaustive. According to Section 2(24), income includes:

(i) Profits and gains.
(ii) Dividend.
(iia) Voluntary contributions received by a trust created wholly or partly for charitable or religious purpose or by an institution established wholly or partly for such purpose.
(iii) The value of any perquisite or profit in lieu of salary.
(iiia) Any special allowance or benefit other than perquisite as above (iii).
(iiib) Allowances granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increase in cost of living.
(iv) The value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid.
(iva) The value of any benefit or perquisite, whether convertible into money or not, received by a representative assessee as per Section 160, agent of a nonresident, guardian of a minor, lunatic, deceased person, etc.
(v) Any sum chargeable to income tax u/s 28 sub-clauses (ii) (iii) (iiia) (iiib) or (iiic) or Section 41 or Section 59 and the value of any benefit or perquisite taxable under clause (iv) and (v) of Section 28.
(vi) Any capital gains chargeable under Section 45.
(vii) The profit and gains of any business of insurance carried on by a mutual insurance company or by a cooperative society computed in accordance with Section 44; or any surplus taken to be such profits and gains by virtue of provisions contained in the First Schedule.
(viii) Omitted w.e.f. 1.4.1988.
(ix) Any winning from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.
(x) Any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the provisions of the E.S.I. Act, 1948, or any other fund of the welfare of such employees.
(xi) Any sum received under a keyman insurance policy including the sum allocated by way of bonus on such policy.
(xii) Any sum referred to in clause (va) of Sec. 28.
(xiii) Any consideration money received in excess of fair market value of the shares issued during the previous year should be treated as income of the closly held company.

(13) Casual Income

There is no definition of the term casual income under Income Tax Act. According to Oxford Dictionary, casual means sudden, by chance, accidental, etc. Casual income refers to a receipt which is casual and non-recurring in nature. It is accidental and without any stipulation. It is an unexpected and windfall gain.
Casual incomes are taxable under the head Income from Other Sources. However, the following should not be treated as casual income :

(a) Gift or purely personal nature receipts.

(b) Income taxable under the head Capital Gains.
(c) Income taxable under the head Income from profit and gains of business or profession.
(d) Tips given to hotel employees.
(e) Voluntary payment received in exercise of occupation.
(f) Bonus received by employee.

(14) Distinction between Heads of Income and Source of Income

As per Section 14 of the Act, all the income shall, for the purpose of charge of Income tax and computation of total income, be classified under five heads of Income :

(i) Salaries;
(ii) Income from house property;
(iii) Profits and gains of business or profession;
(iv) Capital gains; and
(v) Income from other sources.

An income under any head may derive from different sources. For example, an asses-see may have five source of Income from five house property he owns, but the incomes from these five heads will appear under the head "Income from House Property".

Following are the basic points of distinction between the Heads of Income and Source of Income :

Source of Income	Heads of Income
(i) Source of Income means the origin of income wherefrom those are generated. (ii) There are various sources of income without any restriction or there are no definite number or list of sources of Income. (iii) Source of Income are not defined in the Act in that manner. It depends on the notion or idea about the Income. Source of Income is not governed by any provision or section of the relevant laws. (iv) By aggregating the different sources of income, it constitutes the incomes under different heads. (v) A source of income usually helps to diagnose the head under which it may be included. But the source cannot say the final word. (vi) Different sources of Income are under one head.	(i) Heads of Income means the categories in which the incomes fall for Taxation Purpose. (ii) According to Income Tax Act of India there are five specific heads of Incomes. (iii) Heads of Income is a legal concept following under the Taxation laws with specific definition of each head of Income and with specific sections like Salary section 15-17, House property, Sections 22-27 etc. (iv) By aggregating incomes under different heads, the Gross total income is found out. (v) The head depends upon other factors as well, like the natur of the income and its individual characteristics. (vi) But heads of income are not under the different sources.

(B) Wealth Tax Act, 1957

Definition of Assets [Sec. 2(ea)(i)]

Assets includes property of every description, movable or immovable are defined in Section 2(*ea*) as follows —

(1) Guest House, Residential House or Commercial Building [Sec. 2(ea)(i)]

The following are treated as "assets" -

(i) Any building or land appurtenant thereto whether used for commercial or residential purposes or for the purpose of guest house
(ii) A farm house situated within 25 kilometers from the local limits of any municipality (whether known as a municipality, Municipal Corporation, or by any other name) or a cantonment board.

The following are not included in "Assets":

(a) A house meant exclusively for residential purposes and which is allotted by a company to an employee or an officer or a director who is in whole-time employment, having a gross annual salary of less than ₹ 10,00,000;
(b) Any house for residential or commercial purposes which forms part of stock-in-trade;
(c) Any house which the assessee may occupy for the purposes of any business or profession carried on by him;
(d) A residential property that has been let out for a minimum period of 300 days in the previous year;
(e) Any property in the nature of commercial establishments or complexes.

State whether following property are asset or not -

Particulars	**Whether assets u/s 2(ea)(i)**	**Reason**
A residential house given on rent for 300 days during the Previous Year	No	Residential house rented for more than 300 days are excluded from the definition of assets.
A residential house given on rent for 299 days during the Previous Year	Yes	Residential house rented for less than 300 days.
A commercial house given on rent for 320 days during the Previous Year	Yes	Commercial house falling under the category of commercial establishments.
A guest house of the company dealing in furniture	Yes	Guest house covered under the definition of assets.
Farm house situated within 25 k.m. of Howrah/ Municipal board	Yes	Farm house (to be measured aerially) covered under the definition of assets.
Factory building used for own business	No	House which the assessee occupy for the purposes of own business or profession carried on by him is excluded from the definition of assets.
A residential flat allotted to its employee by a Individual/HUF where the salary of the employee is ₹9,99,000 p.a.	Yes	A residential house **which is allotted by a company** to an employee having a gross annual salary of less than ₹10,00,000 is not an asset.
A residential flat allotted to its employee by a company where the salary of the employee is ₹9,99,000 p.a.	No	A residential house which is allotted by a company to an employee who is in whole-time employment, having a gross annual salary of less than ₹10,00,000 is not an asset.
A residential flat allotted to its employee (having substantial interest) by a company where the salary of the employee is ₹ 9,99,000 p.a.	No	A residential house which is allotted by a company to an employee who is in whole-time employment, having a gross annual salary of less than ₹10,00,000 is not an asset.
A commercial shop let out to its whole time director by a company where the salary of the employee is ₹9,99,000 p.a.	Yes	A house meant **exclusively for residential purposes** and **which is allotted** by a

		company to an employee having a gross annual salary of less than ₹10,00,000.
A residential flat let out to its whole time director by a company where the salary of the employee is ₹9,99,000 p.a.	Yes	A house meant exclusively for residential purposes and **which is allotted** by a company to an employee having a gross annual salary of less than ₹10,00,000.
A residential flat let out to its Part time director by a company where the salary of the employee is ₹9,99,000 p.a.	Yes	A house meant exclusively for residential purposes and which is allotted by a company to an employee or an officer or a director who is in **whole-time employment**, having a gross annual salary of less than ₹10,00,000.
A shop held by an individual as stock in trade	No	Any house for residential or commercial purposes which forms part of stock-in-trade.
A commercial establishment let out for 290 days during the Previous Year	No	Any property in the nature of commercial establishments or complexes – Not an assets.

(2) Motor Cars [Sec. 2(ea)(ii)]
Motor car is an "asset", except the following -
(a) Motor cars used by the assessee in the business of running them on hire;
(b) Motor cars treated as stock-in-trade.
In the case of a leasing company, motor car is an asset.
"Motor car" covers all motor vehicles other than heavy vehicles.

State whether following property are asset or not –

Particulars	Whether assets u/s 2(ea)(ii)	Reason
Motor car held as fixed asset in a company engaged in the business of iron & steel	Yes	Neither motor car has not been used by the assessee in the business of running them on hire nor it is treated as stock - in - trade.
Motor car held as fixed asset in a company used by an employee for personal purpose	Yes	Neither motor car has not been used by the assessee in the business of running them on hire nor it is treated as stock- in - trade.
Motor car held by an individual as personal effect	Yes	Neither motor car has not been used by the assessee in the business of running them on hire nor it is treated as stock- in - trade.
Motor car held as stock in trade	No	Motor cars treated as stock-in-trade are not

		assets.
Motor car held by an individual/HUF/Company for running them on hire	No	Motor cars used by the assessee in the business of running them on hire are not assets.

(3) Jewellery, bullion, furniture, utensils of gold, silver, etc. [Section 2(ea)(iii)]

Jewellery, bullion, furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals are treated as "assets".

For this purpose, "jewellery" includes -

(a) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones, and whether or not worked or sewn into any wearing apparel;

(b) precious or semi-precious stones, whether or not set in any furniture, utensils or other article or worked or sewn into any wearing apparel.

The following are not included in "Assets":

(a) Where any of the above assets (i.e., jewellery, bullion, utensils of gold, etc.) is used by an assessee as stock-in-trade, then such asset is not treated as "assets" under section 2(ea)(iii).

(b) Jewellery does not include the Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by Central Government.

State whether following property are asset or not -

Jewellery	**Whether assets u/s 2(ea)(iii)**	**Reason**
Gold biscuit (not held as stock in trade)	Yes	Jewellery, **bullion,** furniture, utensils or **any other article made wholly or partly of gold**, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals are treated as "assets.
Silver made furniture held for house hold purpose	Yes	Jewellery, bullion, **furniture**, utensils or any other article **made wholly or partly of gold, silver**, platinum or any other precious metal or any alloy containing one or more of such precious metals are treated as "assets.
Jewellery given as security for business loan	Yes	Ownership of the Jewellery is with the assessee. So it is assessed in the hand of the assessee as on the valuation date.
Gold furniture held by a company used for office purpose	Yes	Jewellery, bullion, furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy

		containing one or more of such precious metals are treated as "assets. No matter whether it is used for official purpose or not.
Golden necklace of house-wife	Yes	Jewellery, bullion, furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals are treated as "assets.
Jewellery held as stock in trade	No	Where jewellery, bullion, utensils of gold, etc. is used by an assessee as stock-in-trade, then such asset is not treated as "assets.
Jewellery held for personal purpose converted into stock in trade as on the valuation date.	No	Where jewellery, bullion, utensils of gold, etc. is used by an assessee as stock-in-trade, then such asset is not treated as "assets.

(4) Yachts, boats and aircrafts [Sec. 2(ea)(iv)]

Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes) are treated as "assets".

State whether following property are asset or not -

Aircraft	Whether assets u/s 2(ea)(iv)	Reason
Aircraft used for hiring purpose	No	Aircraft used for commercial purposes.
Aircraft used for personal purpose	Yes	Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes) are treated as "assets".
Aircraft given to manager by a company dealing in readymade garments	Yes	Aircraft used for personal purposes.
Aircraft held by Indian Air Lines	No	Indian Airlines used aircraft for commercial purposes.

(5) Urban land [Sec. 2(ea)(v)]

An "urban land" is an assets whether it is agricultural land or non-agricultural land.

Urban land means land situated in —

(i) Any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or any other name) or a cantonment board and which has a population of not less than 10,000;

(ii) Any area within distance (to be measures aerially) given below-

≥ 2 kilometers from the local limits of any municipality/ cantonment board as referred above	Population more than 10,000 but not more than 1 lakh.
≥ 6 kilometers from the local limits of any municipality/ cantonment board as referred above	Population more than 1 lakh but not more than 10 lakh.
≥ 8 kilometers from the local limits of municipality/ cantonment board as referred above	Population more than 10 lakh

- "Population" means the population according to the last preceding census of which the relevant figures have been published before the valuation date.

The following are not included in "Assets":

(i) Land classified as agricultural land in the records of the Government and used for agricultural purposes; or

(ii) Land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated; or

(iii) The land occupied by any building which has been constructed with the approval of the appropriate authority; or

(iv) Any unused land held by the assessee for industrial purposes for a period of 2 years from the date of its acquisition by him; or

(v) Any land held by the assessee as stock-in-trade for a period of 10 years from the date of its acquisition by him.

State whether following property are asset or not -

Particulars	**Whether assets u/s 2(ea)(v)**	**Reason**
Land situated within the jurisdiction of a municipality or a cantonment board, which has a population of 9,900 as per the last census [< 10,000]	No	Population is less than 10,000.
Urban land on which a building is constructed with permission	No	The land occupied by any building which has been constructed with the approval of the appropriate authority is not an asset.
Urban land on which a building is not constructed however construction is permitted under the law.	Yes	Land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated is not an asset. Hence the urban land is fall under the category of assets.
Urban land on which a building (residential or commercial) is constructed without the approval of appropriate authority	Yes	The land occupied by any building which has been constructed with the approval of the appropriate authority is not an asset.
Urban land held as stock in trade acquired in 1997	Yes	The land is held by the assessee as stock-in-trade for more than 10 years.
Urban land held as stock in trade acquired in 2011	No	The land is held by the

		assessee as stock-in-trade for less than 10 years.
Urban unused land acquired for industrial purpose on 17th July, 2013.	No	Unused urban land held by the assessee for industrial purposes for less than 2 years from the date of its acquisition.
Urban unused land acquired for industrial purpose on 17/7/2005	Yes	Unused urban land held by the assessee for industrial purposes for more than 2 years from the date of its acquisition.
Urban land acquired for industrial purpose on 17th July, 2013 for the time being used for agricultural purpose	Yes	The assets has been used for agriculture purpose.

(6) Cash in hand [Sec. 2(ea)(vi)]
In case of individual and HUF, cash in hand on the last moment of the valuation date in excess of ₹50,000 is an 'asset'. In case of companies, any amount not recorded in books of account is 'asset'.

State whether following property are asset or not -

Particulars	Whether assets u/s 2(ea)(vi)	Reason
Bank balance in Current account	No	**For Individual –** cash in hand in excess of ₹50,000 is an 'asset. **For Company -** any amount not recorded in books of account is 'asset'.
Cash balance at the end of financial year deposited in Bank at the last moment.	No	**For Individual –** cash in hand in excess of ₹50,000 is an 'asset. **For Company -** any amount not recorded in books of account is 'asset'.
X Ltd. has physical cash balance of ₹60,000, the same amount is shown in the cash book	No	**For Individual –** cash in hand in excess of ₹50,000 is an 'asset. **For Company -** any amount not recorded in books of account is 'asset'.
Mr. X has physical cash balance of ₹60,000, the same amount is shown in the cash book	Yes, upto ₹10,000	**For Individual –** cash in hand in excess of ₹50,000 is an 'asset. **For Company -** any amount not recorded in books of account is 'asset'.
Mr. X has physical cash balance of ₹30,000 and balance in current account of ₹45,000	No	**For Individual –** cash in hand in excess of ₹50,000 is an 'asset. **For Company -** any amount not recorded in books of account is 'asset'.

Illustration 1

Whether the following assets are "asset u/s 2(ea) of the Wealth Tax Act 1957

Particulars	Whether assets u/s 2(ea)(vi)
Urban land on which a building (residential or commercial) is constructed with the approval of an appropriate authority	No
Urban land on which a building (residential or commercial) is constructed without the approval of appropriate authority	Yes
Shares, debentures, fixed deposits in bank, plant & machinery, units of a mutual fund, amount recoverable from the Government, sundry debtors, Goodwill and Stock in trade	No
In the cash book of an individual/HUF opening balance as on the valuation date is ₹1,85,000 out of which the assessee deposits ₹1,35,000 in his current account with the Citi Bank before the closure of banking hours on the same day (no other inflow and outflow of cash as on the same day).	Since, at the time of valuation i.e. last moment of valuation date the cash balance is only ₹50,000 hence assets u/s 2(ea) shall be taken as Nil.
Motor cars used by a person in the business of running them on hire to tourists (Indian or foreign citizen) or to other person.	No, since the cars are used for running them on hire.
Residential house owned by a company and allotted to a part time director whose salary is ₹1,00,000 p.a.	Yes, as the director is not a whole time director.
Farm house which is not situated within 25 kms of any municipality or a cantonment board.	No
Diamond held as stock in trade	No
Diamond held as Fixed asset	Yes
Diamond held as a personal asset by a business man	Yes

Guest house held as stock-in-trade by a property dealer	No
Guest house (not held as stock-in-trade) for entertaining personal guests	Yes
Farm house which is situated 30 kilometres from local limits of Delhi but within 6 kilometres from Faridabad	Yes
Factory building, office building and godown building used for the purpose of carrying on own business or profession	No
Factory building and godown building given on rent	Yes, if it is letout less than 300 days.
Residential house owned by an individual (or Hindu undivided family) and allotted to one of his full-time employees whose salary (including commission, bonus and allowances) is ₹ 83,332 per month	Yes, house is allotted by individual or HUF.
Residential house owned by a company and allotted to a part-time director whose salary is ₹ 6,00,000 per annum	Yes, house was not allotted to full time director.
Residential house owned by a company and allotted to one of its officers/employees/full-time directors whose salary (including commission, bonus and allowances) is : a. ₹ 83,333.00 per month b. ₹ 83,334.00 per month	 No Yes
A residential or commercial building held as stock-in-trade	No
Residential house owned by a company and allotted to an employee/full-time director (or managing director) whose salary is less than ₹ 10,00,000 per annum and who owns 90 per cent equity share capital in the company	No
A commercial complex having 20 offices given on rent by the owner	No
A multi-storey office complex given on rent	No
A residential house given on rent for 300 days during 2014-15	No
Motor car (Indian as well as foreign) held as : a. stock-in-trade b. fixed assets c. personal asset by a salaried employee d. personal asset by a businessman e. fixed asset by a company and given for business use to full-time-employee or a director drawing less than ₹10,00,000 per annum	 No Yes Yes Yes Yes
Motor cars used by a person in the business of running them on hire to tourists (Indian or foreign citizens) or to other persons	No
Silver, gold, jewellery, bullion, etc., owned by a jeweller (as stock-in-trade)	No
Gold owned by an individual (not as stock-in-trade)	Yes

Gold/silver furniture held by a company (not as stock-in-trade)	Yes
Aircraft used by a manufacturing company having turnover of ₹ 400 crore for use by its directors	No
Aircraft owned by an individual (not as stock-in-trade) for giving it on lease to others	No
Urban land on which a building (residential or commercial) is constructed : a. with the approval of an appropriate authority b. without the approval of an appropriate authority	 No Yes
Urban land on which construction is not permitted	No
Vacant urban land (on which construction is permissible) owned by a person since 1990	Yes
Urban land held as stock-in-trade and which was acquired — a. on June 1, 2004 b. on June 1, 2005	 Yes No
Urban unused land held by an assessee, for industrial purposes (whether or not construction is started) and which was acquired : a. on April 1, 2013 b. on March 31, 2013	 No Yes
Urban land held by an assessee for industrial purposes (as construction of factory will be started during November 2014, it is used for agricultural purposes on temporary basis) and it was acquired on — a. April 1,2012 b. March 31, 2012	 Yes Yes
Land acquired in 1965 (it may be used for construction of any building — residential or commercial) and a. situated within the jurisdiction of a municipality having population of less than 10,000 b. situated within the jurisdiction of a municipality having population of 10,000 or more	 No Yes

Preventive Maintenance and Breakdown Maintenance

Preventive Maintenance is carried out to prevent failure of a machine or plant. It is undertaken before the failure occurs or before the breakdown actually happens. It is a safety measure.

Breakdown Maintenance is carried out as and when a machine actually breaks down. It is a sort of corrective maintenance, as it is undertaken to restore an equipment to an acceptable standard, after the breakdown has occurred.

Preventive maintenance consists of:

- Proper design and installation of equipment
- Periodic inspection of plant and equipment to prevent breakdowns before they occur
- Repetitive servicing, upkeep and overhaul of equipment and
- Adequate lubrication, cleaning and painting of buildings and equipments.

The key to all good preventive maintenance is inspection. Inspection should cover virtually everything, including production machinery, motors, controls, materials handling equipment, process equipment , lighting, buildings and plant services.

A well-conceived preventive maintenance programme should contain the following features:

- Proper identification of all items to be included in the programme.
- Adequate records covering, volume of work,cost and so forth.
- Inspections on a definite schedule with standing orders on specific assignments
- Use of checklists by inspectors.
- An inspection frequency schedule may vary from as often as once every six hours to as little as once a year.
- Well-qualified inspectors have craftsmen familiar with items being inspected and capable of making simple repairs as soon as trouble is noticed.
- Use of repair budgets for major items of equipment.
- Administrative procedures that provide necessary fulfillment and follow-up on programme.

Advantages of Preventive Maintenance:

- Reduced breakdowns and downtime
- Greater safety to workers
- Fewer large scale repairs
- Less standby or reserve equipment or spares
- Lower unit cost of the product manufactured
- Better product quality
- Increased equipments life
- Better industrial relations

Breakdown maintenance or corrective maintenance occurs when there is a work stoppage because of machine breakdown. Here maintenance means repair work. Repairs are made after the equipment is out of order – an electric motor will not start, a conveyor belt is ripped, or a shaft has broken.

Breakdown or corrective maintenance seeks to achieve the following objectives:

- To get equipment back into operation as quickly as possible in order to minimize interruption to production. This objective can directly affect production capacity, production costs, product quality and customer satisfaction.
- To control the cost of repair crews, including regular time and overtime labour costs.
- To control the cost of operation of repair shops.
- To control the investment in replacement spare parts that are used when machines are repaired.
- To control the investment in replacement spare machines which are also called standup or backup machines. These replace manufacturing machines until the needed repairs are completed.
- To perform the appropriate amount of repairs at each malfunction.

example

1. A workshop has 20 identical machines whose failure pattern is as below:

Elapsed time (months)	No. of machines failed
1	4
2	3
3	3
4	3
5	3
6	4

It cost ₹ 150 to attend to a broken-down machine. A maintenance contractor offers preventive maintenance of the machines and in return guarantees no failure of the machine for one year. He charges ₹ 450 per machine per year. Would you go for preventive maintenance contract?

Solution:

The total cost of preventive maintenance is ₹ 450 × 20 = ₹ 9000 per annum.

From the given data

Expected time before failure in months

= (4/20)× 1 + (3/20)× 2 +(3/20)× 3 + (3/20)×4 + (3/20)× 5 + (4/20)× 6 = 3.5 months

Nos. of repair per machine per annum = 12/3.5

Considering 20 machines and ₹ 150 to attend a failed machine, the yearly

Cost of servicing = (12/3.5) × 20 × 150 = ₹ 10,286

Preventive maintenance, which is only ₹ 9,000 per year would be cheaper, as compared to breakdown maintenance cost which is ₹ 10,286.

2. A Public Transport Corporation has gathered the data about the number of breakdowns for months over the past two years in their new fleet of vehicles:

Number of breakdowns	**0**	**1**	**2**	**3**	**4**
Number of months this occurred	**3**	**7**	**11**	**2**	**1**

Each breakdown cost the firm an average of ₹ 3,000. For a cost of ₹ 1,375 per month, preventive maintenance can be carried out to limit the breakdowns to an average of one per month. Which policy will be suitable for the firm?

Solution:

Converting the frequencies to a probability distribution and determining the expected cost/month of breakdown, we get

No. of breakdowns	Frequency in months	Frequency in Percent	Expected value
0	3	3/24 = 0.125	0.000
1	7	7/24 = 0.292	0.292
2	11	11/24 = 0.458	0.916
3	2	2/24 = 0.083	0.249
4	1	1/24 = 0.042	0.168
		Total	1.625

Breakdown cost/month: Expected cost = 3,000 × 1.625 = ₹4875.

Preventive maintenance cost per month:

Average cost of one breakdown/month = ₹3,000

Maintenance Contract cost/month= ₹1,375

Total ₹ 4,375

Uniform Costing

- This is not a separate method of costing. This is a system of using the same method of costing by number of firms in the same industry. It is treated as a common system of using agreed principles and standard accounting practices in the identical firms or industry.

- This help in fixation of price of the product and inter-firm comparisons.

PURPOSE OF UNIFORM COSTING

- Cost Comparison
- Cost Reduction & Cost Control

SCOPE:

Uniform Costing method can be advantageously applied:

- In single organization having number of branches.
- In a number of firms in the same industry who are inter connected through trade association.
- In industries which are similar such as cotton, gas and electricity.

OBJECTIVES:

- **To avoid competition:** It eliminates cut-throat competition by fixing common prices on the basis of uniform costing procedures. It thus also aims at bringing stability in prices of the products.
- **Cost comparison:** It enables different firms to compare the costs because the costs are based on same principles. Thus, their profitability can also be compared.
- **Measurement of efficiency:** Comparison of costs and profitability helps in measurement of efficiency. Uniform costing enables the member participants to use this system as yardstick of their achievements and performances.
- **Reliable prices:** The confidence is reposed in the public where the prices fixed are based on sound and uniform costing principles. This will result in better and cordial relations between members adopting this system and their customers.
- **Cost control:** One of the objectives of uniform costing is an effective control over costs. This facilitates location of unprofitable ventures. Uneconomies and inefficiencies are revealed at every stage. The uniform cost serves as the standard cost and helps in controlling the off-standard performances.
- **Better exchange of information:** Members having technical knowledge provide the benefit of their experience to others. Free exchange of information leads to reduction in costs and improvement in the quality of the product.

Why is uniform costing implemented?

Uniform costing method is implemented due to the following advantages:

- A useful tool for management control as the individual performance is measured against norms set for the industry as a whole.
- It avoids cut-throat competition.
- Weaker units can take the advantage of the efficient method of production so as to increase their own efficiency.
- The achievements in research and development programmes may be shared by the bigger units with the smaller units.
- Provides the best cost control system or cost presentation in the entire industry.
- It assists in educating the less informed units regarding the cost accounting methods.
- It enables a comparative assessment between the two sectors.
- It helps the government in regulating prices of essential and important items.
- It helps in price fixation.

- It simplifies the work of wages boards to fix minimum and fare wages for an industry.
- It helps trade association in negotiating the government in the trade matters.

LIMITATION OF UNIFORM COSTING

- ❖ It may not be possible to adopt uniform standard methods and procedures of costing in different firms because of different circumstances in which they operate.
- ❖ Disclosure of cost information is the essential requirement. Many firms do not wish to share such information with their competitors.
- ❖ Small firms believe that uniform costing is only meant for big and medium sized firms because the small firms cannot afford it.
- ❖ It induces monopolistic trend because due to which prices may be increased artificially and supplies withheld.

ESSENTIAL REQUISITES FOR INSTALLATION OF UNIFORM COSTING

The following are the essential requisites to be considered for the installation of uniform costing system

- ❖ The firm's in the industry should be willing to share/ furnish relevant data or information.
- ❖ A spirit of cooperation and mutual trust should prevail among the participating firms.
- ❖ Mutual exchange of ideas, methods used, special achievement made, research and know how etc. should be frequent.
- ❖ Bigger firms should take the lead towards sharing their experience and knowhow with the smaller firm to enable the latter to improve their performance.
- ❖ In case of accounting methods, principles, procedure and production method uniformity must be established.

EXAMPLE:

The share of production and the cost-based fair price computed separately for a common product for each of the four companies in the same industry are as follows:

	A	B	C	D
Share of Production (%)	40	25	20	15
Costs:				
Direct materials (₹ /Unit)	75	90	85	95
Direct Labour (₹ /Unit)	50	60	70	80
Depreciation (₹ /Unit)	150	100	80	50
Other Overheads(₹ /Unit)	150	150	140	120
Total (₹ / Unit)	425	400	375	345
Fair Price (₹ /Unit)	740	615	550	460
Capital employed per Unit:				
(i) Net Fixed Assets(₹ /Unit)	1,500	1,000	800	500
(ii) Working Capital (₹ /Unit)	70	75	75	75
Total (₹ /Unit)	1,570	1,075	875	575

Required:
What should be the uniform price that should be fixed for the common product?

SOLUTION:

Assume Total Production = 100

	A	B	C	D	Total
Price	740	615	550	460	
(-)Cost	425	400	375	345	
Profit per unit	315	215	175	115	
Share of production (%)	40	25	20	15	
Total Return	12,600	5,375	3,500	1,725	23,200
Capital Employed	1,570 x 40	1,075 x 25	875 x 2	575 x 15	1,15,800

$\therefore$ Average Return on Capital Employed = $\frac{23,200}{1,15,800}$ = 20% (approx)

Calculation of Uniform Price

A	[425 + (20% of 1,570)] x 40	29,560
B	[400 + (20% of 1,075)] x 25	15,375
C	[375 + (20% of 875)] x 20	11,000
D	[345+ (20% of 575)] x 15	6,900
	Total Cost + Profit	62,835
	No. of Units	100

Uniform Price Per Unit $\left(\frac{62,835}{100}\right)$ = 628.35

Inter-Firm Comparison

- Inter-Firm Comparison is the technique of evaluating the performance, efficiencies, costs and profits of firms in an industry.

ESSENTIAL REQUISITES OF INTER-FIRM COMPARISON

The following are the essential requisites of inter-firm comparison to be considered to achieve the objectives of the concern:

- There must be a center for inter-firm comparison.
- Firms should become members of that center.
- The nature of information to be collected should be decided upon.
- The method of collection and presentation of information should be laid down

ADVANTAGES OF INTER-FIRM COMPARISON

- It is a yardstick of performance. It helps to evaluating the overall performance of the concern.
- It facilitates cost control and cost reduction among participating industries.
- It creates cost consciousness among the personnel.
- Inter-firm comparison helps to reveal the efficiency and inefficiency of performance. The inefficiency operations is analysed and immediate actions can be taken.
- It helps to the management in formulating policies and production planning.
- It is a guide to the experts in the field of research and development in future.
- It provides necessary information to the management of participating units to make proper decisions.

DISADVANTAGES

- Lack of suitable base for inter-firm comparison.
- Participating firms are not willing to disclose their true facts and figures.
- Lack of confidence and good faith among common units, lead to difficult in measure the operational efficiency.
- For small concerns, inter-firm comparison is expensive.
- Shortage of expert personnel.

Indirect Tax
CENVAT Credit Rules, 2004

Following is the basic outline of the CENVAT Credit

Avoid cascading effect	Basic purpose of vat is to eliminate cascading effect of taxes by tax credit system. This is done through mechanism of input tax credit.
Destination Principle	CENVAT is based on destination principle i.e. excise duty/ service tax is paid only when goods are consumed. Till then, burden of duty gets passed on to the next buyer/customer. [In case of sales tax, as per this principle, sales tax is payable in the state in which goods are consumed and not in the state where goods are produced.]
Credit of inputs, Input Services and Capital Goods	CENVAT scheme allows credit of excise duty paid on Input goods, Capital, goods and Service Tax paid on Input Services Rule 3(1) of CENVAT Credit Rules.
Utilisation of CENVAT Credit	This credit can be utilised for payment of excise duty on dutiable final products and Service Tax on taxable output service [Rule 3(4) of CENVAT Credit Rules]
Credit only if manufacture or provision of service	CENVAT Credit is available only if there is manufacture or provision of taxable output service
One to one relation not required	CENVAT Credit Rules do not require one to one relationship [Rule 3(1) read with 3(4) of CENVAT Credit Rules]. Entire CENVAT Credit is common pool which can be utilised for payment of any eligible duty, Service Tax or amount.

Input (goods) eligible for CENVAT Credit

Inputs used in or in relation to manufacture	Inputs which are used in or in relation to manufacture of taxable final product and inputs directly used for provision of taxable output service are eligible for CENVAT Credit [Rule 2(k) of CENVAT Credit Rules]. Input may be used directly or indirectly in manufacture. Any input integrally connected with manufacturing process is eligible. Process loss is eligible.
Consumables eligible	Consumables are eligible for CENVAT Credit.
Accessories, packing material, paint	Accessories, packing material and paints are eligible as input
LDO,HSD and Petrol not eligible	LDO, HSD and Petrol are not eligible for CENVAT Credit [Explanation 1 to Rule 2(k) of CENVAT Credit Rules]
Cement, angles, channels etc. not eligible	Input does not include cement, angles, channels, CTD or TMT used for construction of factory shed, building or foundation or structures to support capital goods. [Explanation 2 to Rule 2(k) of Credit Rules]

Input directly used for providing service	Definition of 'input' is restricted for service providers, only inputs used directly in providing taxable service are eligible. If service provider charges separately for material supplied while providing services, its cost is not includible. Correspondingly, duty paid on such material is not cenvatable.
Instant credit	CENVAT Credit on input (goods) is instant i.e. as soon as inputs are received in the factory.

Input Service

Input service eligible for CENVAT Credit	CENVAT credit is available of Service Tax paid on input services. Definition of 'Input Service' is very wide [Rule 2(1) of CENVAT Credit Rules] Inclusive part of the definition expands the scope much beyond manufacture or provision of taxable service.
Any Service in relation to business is Input Service	Decision in Coca Cola (Bombay High Court) and ABB (LB of CESTAT) have cleared most of doubts about interpretation of 'Input service' and it is clear that any relation with manufacture or provision of taxable service is not required any service in relation to business of manufacturer or service provider is 'input service.'
Credit only after payment of bill	Credit of Service tax on input services is available only after payment is made to bill including Services tax to service provider for service [Rule 47) of CENVAT credit Rules]

Input Service Distributor and Input Credit Distribution

Utilisation of credit of Service Tax paid at H. O. depots	Service Tax paid at Head Office, Regional/Branch Office can be utilised through mechanism of Input Service Distributor'. They should be registered and pass credit through invoice [Rules 2(m) and 7 of CENVAT credit Rules]
Distribution of credit through Invoice	The 'Input Service Distributors can distribute CENVAT Credit of Service Tax availed by it by issuing an Invoice to its manufacturing units or unit providing output service. The Invoice should have details as required in Rule 4A (z) of Service Tax Rules.
Distribution can be in ratio	The distribution of credit can be in any ratio. However, total credit distribution should not be more than service tax paid on input services. If some input service is exclusively used for exempted final product/output service, its credit is not available for distribution by Input Service Distribution [Rule 7]
Credit of excise duty on input goods	Input Credit Distributor can distribute credit on duty paid on inputs (goods) if invoice received at H.O. and distributed to other places [Rule 7A of CENVAT Credit Rules] Since CENVAT credit can be passed through mechanism of endorsement of invoice, this facility is not much used.

Capital Goods eligible for CENVAT credit

Capital goods eligible for CENVAT Credit	Only capital goods as defined in Rule 2(a) of CENVAT Credit Rules are eligible for CENVAT Credit. Following capital goods are covered in clause (A) (i) of above definition Tools, Hand Tools, Knives etc. falling under Chapter 82* Machinery covered under Chapter 84* Electrical machinery under Chapter 85* Measuring Checking and Testing machines etc. falling under Chapter 90* Grinding wheels and the like parts thereof falling under Sub-heading No 6804* Abrasive powder or grain on base of textile materials of

	paper, or paper board or other materials, falling under Chapter heading 6805. Dumpers or tippers falling under Chapter 87 are eligible as Capital goods for CENVAT Credit to providers of service of site formation and clearance, excavation and earthmoving and demolition [Section 65 (105) (zzza)] and mining of mineral, oil or gas services [Section 65 (105) (zzzy)], if these are registered in name of service provider and are used for providing taxable service (amendment w.e.f. 22-6-2010). This definition is quite different from 'capital goods' and understood in conventional accounting or under income tax.
Equipment or appliance used in office not eligible to manufacture	Capital goods does not include equipment or appliance used in an office of manufacturer (this restriction does not apply to service provider)
Capital goods to be used in factory	Capital goods should be used in the factory of manufacturer or for provision of output service.
Eligibility of Motor Vehicles	Motor vehicle is capital goods. Only in respect of specified service providers (Rule 2(a) (B) of CENVAT Credit Rules]
Sending out capital goods	Capital goods should be used in factory. These can be sent outside for job work but should be brought back within 180 days. [Rule 4 (5) (a) of CENVAT Credit Rules[Moulds, dies, jigs and fixtures can be sent outside without restriction of return within 180 days [Rule 4(5) (b) of CENVAT Credit Rules]
Partial use of capital goods for exempted goods allowable	Capital goods used exclusively for manufacture of exempted goods are not eligible for CENVAT Credit. Thus partial use for exempted goods is allowable, i.e. full CENVET Credit is available.
Capital goods on hire purchase/lease/ loan	Capital goods obtained on hire purchase/lease loan are eligible [Rule 4(3) of CENVAT Credit Rules]
Duty paying documents	Duty paying documents eligible are same for CENVAT on inputs.
Depreciation should not be availed on CENVAT portion	Depreciation under Section 32 of Income Tax Act should not be claimed on the excise portion of the Capital Goods. Rule 4 (4) of CENVAT Credit Rules (otherwise, the manufactures will get double deduction for Income Tax—one credit as CENVAT and another credit as—depreciation] e.g. if cost of 'Capital Goods'is ₹1.16 lakh, out of which ₹0.15 lakh is duty paid, assesse can claim depreciation under Income Tax only on ₹1 lakh, if he has availed CENVAT Credit of ₹0.16 lakh. The requirement gets satisfied only if the assessee follows accounting procedure specified in guidelines issued by Institute of chartered Accounts of India.
Credit to be availed in two instalments	CENVAT credit on capital goods is required to be availed in more than one year. i.e. upto 50% credit can be availed when these are received and balance in any subsequent Financial Year. The condition for taking balance credit is that the capital goods should be in possession of manufacturer of final products in subsequent years. SSI units can avail entire 100% CENVAT Credit in first year itself. Rule 4(2) (a) of CENVAT Credit Rule.
Removal of capital goods as such, after use or as scrap	Capital goods on which CENVAT Credit was taken cab be removed 'as such' on payment of 'amount' equal to CENVAT Credit availed [Rule 3(5) of CENVAT Credit Rules] If Capital goods on which CENVAT was availed are removed as scrap, an 'amount' equal to duty on scrap value is payable [Rule 3(5A) of CENVAT Credit Rule] If Capital goods are cleared after use as second hand Capital goods, 'amount' is payable at reduced rate by reducing credit taken @2.5% per quarter.

Availment of CENVAT Credit

What is 'CENVANT Credit'	CENVAT Credit' is a pool of duties and taxes paid on inputs, Capital goods and input services as specified in Rule 3(1) CENVAT Credit Rules.
Procurement of goods form EOU	In respect of inputs/capital goods procured from EOU unit. CENVAT credit is available equal to CVD and special CVD paid and education cess and SAM education cess w.e.f. 7.9.2009 (earlier it was allowable as per a complicated formula) Rule 3(7) (a) of CENVAT Credit Rules.
CENVAT Credit should be availed within 6 months	CENVAT Credit on Inputs & Input Services to be taken within six months of the date of issue of Invoice or any other documents specified in Rule 9(1) [Proviso inserted in Rule 4(1) & Rule 4(7) of CENVAT Credit Rules, 2004].
CENVAT Credit available on amount paid as CENVAT Credit under Rule 6(3) in case payment for export is received after extended period is allowed by RBI	CENVAT Credit available on amount paid as CENVAT Credit under Rule 6(3) in case payment for export is received after extended period is allowed by RBI, if the amount is received within one year of the expiry of extended period
CENVAT Credit cannot be transferred from one unit to other unit - Large Taxpayer Units	Hitherto Large Taxpayer units were allowed to transfer CENVAT Credit available with one unit to another. Henceforth, the Large Taxpayer Units shall not be allowed to transfer CENVAT Credit from one unit to another. This is a major set-back for Large Taxpayer units.

Utilisation of

Utilisation for any eligible purpose	CENVAT Credit is a pool. The credit in this pool can be utilised for payment of any excise duty on excise final product and service tax on taxable output service. The credit can also be used for payment of certain 'amounts' [Rule 3(4) of CENVAT Credit Rules]
Credit only of inputs and services received upto end of month	Credit can be utilised only of inputs and output services received upto end of the month [First provision to Rule 3(4) of CENVAT Credit Rules] (even if excise duty/service tax is payable at a later date)
Inter-changeability of credit of various duties	Credit of Basic Excise Duty, CVD special CVD and service tax can be utilised for payment of any duty on final product or service tax on output services, except duty payable u/s 85 of Financial Act on Pan masala and certain tobacco products [Provisions to Rule 3(4) of CENVAT Credit Rules]
Restrictions on inter-changeability	CENVAT Credit of education cess, NCCD and additional excise duty paid on inputs under Section 85 of Finance Act (and corresponding CVD on imported inputs) can be utilised only for payment of corresponding duty on final products i.e. the credit is not inter-changeable.
Credit of special CVD	Credit of special CVD (present rate is @ 4%) u/s 3(5) of Customs Tariff act can be utilised by manufacturer but not by service providers [third provision to Rule 3(4) of CENVAT Credit Rules]
Credit of education cess and SAHE cess	Credit of education cess paid on input goods and paid on input services is interchangeable. Similarly, credit of SAH Education cess paid on input goods and paid on input services is inter-changeable.

Duty Paying document for availing CENVAT Credit

Eligible duty/tax-paying document	CENVAT credit can be availed on basis of eligible duty documents as specified in Rule 9 (1) Invoice of Manufacturer Bill of Entry, Supplementary Invoice. Dealer's Invoice and GAR-7 challan when service receiver is liable to pay service tax are major eligible document.
Transit Invoice	Credit can be availed on basis of transit invoice i.e. on basis of invoice of manufacturer when goods purchased through dealer and name of ultimate buyer is shown as consignee.
Credit cannot be denied on account of minor defects	There is ample case law that CENVAT-Credit cannot be denied for minor defects in duty-paying documents.
No time limit for availing CENVAT Credit	There is no time limit for availing CENVAT Credit can be taken even after 3/4 years.
Endorsement of duty-paying document	Duty/tax paying document need not be in name of the manufacturer using the input/input services for manufacturer/provision of taxable output service. It is sufficient if these are endorsed in his name with certificate that endorser has not availed CENVAT Credit.
Burden of Proof	Person taking credit must take reasonable steps while availing credit. Burden of proof of admissibility of CENVAT Credit is on him [Rule 9 (5) of CENVAT Credit Rules]

Dealer's Invoice for CENVAT

First stage and second stage dealer can issue Cenvatable Invoice	CENVAT Credit can be availed on basis of Invoice issued by dealer registered with Central Excise [Rule 9(1) of CENVAT Credit Rules] First stage and second stage dealer, registered with central Excise, can issue Cenvatable Invoice. First stage dealer mean dealer purchasing goods from manufacturer or his depot or consignment Agent. They have to submit quantity return to department within 15 days from close of quarter [Rule 9(8) of CENVAT Credit Rules]
Optional refund of 4% special CVD.	If the first stage dealer claims refund of special CVD of 4%, the buyer cannot avail CENVAT Credit. (This is not compulsory on dealer it is optional)
Transit Invoice	Transit Invoice is also permissible. In such case, dealer need not be registered, if name of ultimate buyer is shown as consignee in the invoice issued by manufacturer.
CENVAT Credit of CVD and special CVD on imported goods	CENVAT Credit can be availed in respect of imported goods purchased through dealer, by either issuing dealer's invoice or by endorsement of Bill of Entry.

Manufacture of exempted as well as taxable goods and provider of both exempted and taxable services

No credit if final product/ output service exempted	CENVAT Credit is available only if final product is dutiable or Service Tax is payable on output service [Rule 6(1) of CENVAT Credit Rules]

Options available to manufacturer of exempted as well as taxable goods and provider of exempted and taxable services	If asseesee is manufacturing exempted as well as dutiable goods and / or providing taxable as well as exempt services, and availing CENVAT Credit, he has three option (a) maintain separate records of inputs and input services used for exempted, final products/services, (b) If common inputs/input services are utilised for exempted as well as taxable final product/assessee is required to pay 5% 'amount' on exempted final product on 6%, amounts on exempt output services, (c) pay amount proportionate to credit on exempted final product/output service [Rule 6(2) and 6(3) of CENV AT Credit Rules]
Option cannot be changed during the year	Option once availed cannot be changed in the financial year. The option is to all exempted goods/services [Explanation I to rule 6(3) of CENV AT Credit Rules]
Entire credit without proportionate reversal	In case of 16 services covered under Rule 6(5) of CENV AT Credit Rules entire CENV AT Credit is available without proportionate reversal.
Supplies to SEZ, EOU, exports	In case of supplies covered under Rule 6(6) of CENV AT Credit Rules [Exports supplies to SEZ/EOU, specified projects entire credit is available without proportionate reversal.]

Removal of Inputs as such

Removal of inputs as such	Inputs on which CENV AT Credit was taken can be removed 'as such' on payment of amount equal to CENV AT Credit availed [Rule 3(5) of CENV AT Credit Rules]
Sending inputs for job work	Inputs on which CENV AT Credit was availed can be sent outside for job work. These should come back within 180 day, [Rule 4(5) (a) of CENVAT Credit Rules]
Direct despatch from place of job worker	Direct despatch of final product form place of job worker can be done with permission of AC / DC for one financial year [Rule 4 (6) of CENVAT Credit Rules]

Removal of Waste

Waste is final product	Waste is final product for excise purpose and duty is payable as if final product is being cleared. This applies only if waste is produced on manufactured and is excisable goods.
Waste not mentioned in Tariff	If a particular waste is not mentioned in central Excise tariff, neither any amount nor duty is payable at the time of clearance.

Records and returns under CENVAT

Records of CENVAT Credit	Manufacturer/Service provider is required to maintain records of inputs and capital goods, records of credit received and utilised [Rule 9(5) of CENVAT credit Rules]
Return of CENVAT Credit availed and utilized	Returns of details of Cenvat credit availed, Principal Inputs and utilization of Principal Inputs in forms ER-1 to ER-7 is to be submitted [Rule 9A of CENVAT Credit Rules]
Revised return	Revised return of CENVAT Credit can be submitted within 60 days [Rule 9(11) of CENVET Credit Rules]
Returns by dealers, input services distributor	Dealer/Service provider/input service distributor is also required to submit returns [Rule 9 (6) and 9 (10) of CENVAT Credit Rules]

Other provisions relating to CENVAT

SSI to reverse CENVAT at end of year	SSI unit can opt out CENVAT at end of the year. He has to reverse cenvat credit on inputs in stock as on 31st March [Rule 11 (2) of CENVAT Credit Rules]

SSI can take CENVAT of duty on inputs in stock	When he starts payment of duty during financial year after exemption is over, he can avail CENVAT Credit of duty paid on inputs in stock.
Simultaneous exemption	Simultaneous exemption and availment of CENVAT is permissible by SSI only in specified cases.
CENVAT Credit to exporter	Exporter of final product or taxable services can avail CENVAT Credit on input and input services. He can claim refund of CENVAT Credit if he cannot utilize the CENVAT credit for payment of duty on sale made within India on payment of duty [Rule 5 of CENVAT credit Rules]
Refund of credit of input services	Merchant exporter can claim refund of specified input services used while exporting final product.
Transfer, amalgamation of undertaking	If undertaking is transferred, merged or shifted CENVAT Credit can be transferred [Rule 10 of CENVAT Credit Rules]
Penalty for improper CENVAT Credit	Penalty can be imposed for wrongfully taking or utilising CENVAT Credit [Rules 15 and 15A of Cenvat Credit Rules]
Accounting for CENVAT and Stock Valuation	Accounting for CENVAT should be as per guidance note issued by ICAI. Inventory valuation should be as per AS—2 which requires exclusion of CENVAT Credit. However, for Income tax purposes, CENVAT Credit has to be added in valuation in view of Section 145A of Income Tax Act.

Buy – Back of Share

Buy back is repurchasing of its own shares by a company. It generally results in restructuring of capital structure.

All the buy-back related provisions are mentioned in Section 68 and Section 69 of Companies Act, 2013.

Power of Company to purchase its own securities:
The company can purchase its own shares or other specified securities out of —
(a) Its free reserves
(b) The securities premium account; or
(c) The proceeds of the issue of any shares or any other specified securities.
No buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

Conditions for buy-back of shares or other specified securities:

No company shall purchase its own shares or other specified securities as per sec 68(1) of Companies Act, 2013 unless —
(a) The buy-back is authorized by its articles of association.
(b) A special resolution has been passed at a general meeting of the Company authorizing the buy-back.

Buy-back with Board of Directors' approval
Provisions of sec 68 (1) clause (b) shall not apply where —
(i) Buy-back is 10% or less of the total paid-up equity capital and free reserves of the Company and
(ii) Such buy-back has been authorized by the Board of Directors by means of a resolution passed at its meeting.

Limit on Buy-Back
- The buy – back is 25% or less of the total paid-up capital and free reserves of the company.
- All the shares or other specified securities for buy-back shall be fully paid-up.
- The ratio of the aggregate of secured and unsecured debts owned by the company after buy-back shall not be more than twice the paid-up capital and free reserve i.e. Debt-Equity Ratio shall not exceed 2:1
- Central Govt. may by order notify a higher ratio.
- No offer of buy-back under sec 68(2) shall be made within a period of 1 year reckoned from the date of the preceding offer of buy-back, if any .
- Every buy-back should be completed within 1 year from the date of passing of the Special Resolution or the Board Resolution.

Mode of buy-back
- From the Existing Security Holders on a proportionate Basis through Tender offer,
- From the Open Market through
- By purchase of Securities issued to Employees pursuant to a Scheme of Stock Option or Sweat Equity.
- Where a company purchases its own shares out off free reserves , or securities premium account it shall transfer a sum equal to the nominal value of the shares so purchased to the Capital Redemption Reserve Account; and
- It shall disclose details of such transfer in its balance sheet.

ACCOUNTING ENTRIES FOR BUYBACK OF EQUITY SHARES

Transaction	Journal Entry	
1. Amount due on Buyback on Equity Shares	Equity Share Capital A/c Premium on Buyback A/c To Equity Shareholders A/c	Dr. Dr.
2. Sourcing / Providing for Premium payable on Buyback	Securities Premium A/c Profit and Loss A/c General Reserve A/c Other Reserves A/c To Premium on Buyback A/c	Dr. Dr. Dr. Dr.
3. Transferring Divisible Profit to Capital Redemption Reserve Account, to the extent of Nominal Value of Shares bought back	Profit and Loss A/c General Reserve / Revenue Reserves A/c Other Divisible Profits A/c (e.g. Dividend Equalization Reserve) To Capital Redemption Reserve A/c	Dr. Dr. Dr.
4. Payment to Equity Shareholders	Equity Shareholders A/c To Bank A/c	Dr.

Example 1:
The share capital of M Ltd. consists of 1,00,000 equity shares of ₹10 each, and 25,000 preference shares of ₹100 each, fully called up. Its Securities Premium account shows a balance of ₹40,000 and General Reserve of ₹7,00,000. The company decides to buy-back 30,000 equity shares of ₹12 each. For this purpose, it utilises the securities premium in full and general reserve to the extent necessary.
Pass the necessary journal entries only showing the effects on the securities premium account and the general reserve account.

Journal Entries

Particulars	Dr. (₹)	Cr.(₹)
Equity Share Capital A/c Dr. Securities Premium A/c Dr. General Reserve A/c Dr. To, Equity Shareholders A/c (Being the amount due to equity shareholders for buying-back of 30,000 equity shares)	3,00,000 40,000 20,000	 3,60,000
General Reserve A/c Dr. To, Capital Redemption Reserve A/c (Being the nominal amount or equity shares bought back transferred)	3,00,000	 3,00,000

No of shares to be bought back:
The maximum number of shares to be bought back is determined as the least of 'number of shares' arrived by performing the following tests:
1. Share outstanding test
2. Resource test
3. Debt Equity Ratio Test.

1. Share outstanding test:
(a) Ascertain the number of shares (Paid up share capital)
(b) 25% of the number of shares is eligible for buy back with the approval of share holders.

2. Resource test:
(a) Ascertain shareholders funds (Capital + Free reserves)
(b) Ascertain number of shares as follows = Share holders' funds /Buy back price.

3. Debt Equity ratio test:
After buy back, the company has to maintain a debt equity ratio of 2:1
(a) Compute total borrowed funds
(b) Ascertain the minimum equity (shareholders funds)
(c) Ascertain present equity (share holders funds)

(d) Compute maximum possible dilution in equity in Step (a) – Step (b)
(e) Calculate the number of shares = Amount in step (d)/Buy back price.

- On determination of quantum of buy back, the shares are bought from public at the buyback price.
- Amount paid in excess of the cost of the share will be debited to reserves after adjusting against securities premium, if any available as usual.
- A transfer is to be made to capital redemption reserve equivalent to capital redeemed also.

Example: 2

XYZ Ltd. has the following capital structure on of 31st March. Equity Share capital (Shares of ₹ 10 each) ₹300 Crores.

Reserves & Surplus:

General Reserve	**₹270 Crores**
Security Premium	**₹100 Crores**
Profit and Loss A/c	**₹50 Crores**
Export Reserve (Statutory reserve)	**₹80 Crores**
Loan Funds	**₹800 Crores**

The shareholders have on recommendation of Board of Directors approved vide special resolution at their meeting on 10th April 2014 a proposal to buy back maximum permissible equity shares considering the huge cash surplus following Account of one of its divisions.

The market price was hovering in the range of ₹25 and in order to induce existing shareholders to offer their shares for buy back, it was decided to offer a price of 20% above market.

Advice the company on maximum number of shares that can be bought back and record journal entries for the same assuming the buyback has been completed in full within the next 3 months.

If borrowed funds were ₹ 1,200 Lakhs, and ₹ 1,500 Lakhs respectively would your answer change?

Solution:

1: Shares outstanding test

Particulars	Amount (₹)
a. No. of shares outstanding	30 crores
b. 25% of shares outstanding	7.5 crores

2: Resources Test

Particulars	Amount (₹)
a. Paid up capital	300 Crores
b. Free reserves	420 Crores
c. Shareholders fund (a+b)	720 Crores
d. 25% of shareholders fund	180 Crores
e. Buyback price per share	30
f. Number of shares that can be bought back	6 Crores

3: Debt Equity Ratio Test

Particulars	Situation I	Situation II	Situation III
Borrowed Funds	800	1,200	1,500
Minimum equity to be maintained after buy back in the ratio 2:1	400	600	750
Present equity	720	720	720
Maximum possible dilution in equity	320	120	N.A.
Maximum shares that can be bought back @ ₹ 30 per share	10.67	6	Buy-back is not possible

Maximum shares that can be bought back

Particulars	Situation I	Situation II	Situation III
a. Shares outstanding test	7.5	7.5	7.5
b. Resource test	6	6	6
c. Debt-Equity ratio test	10.67	4	-
d. Maximum number of shares for buy-back – least of the above	6	4	-