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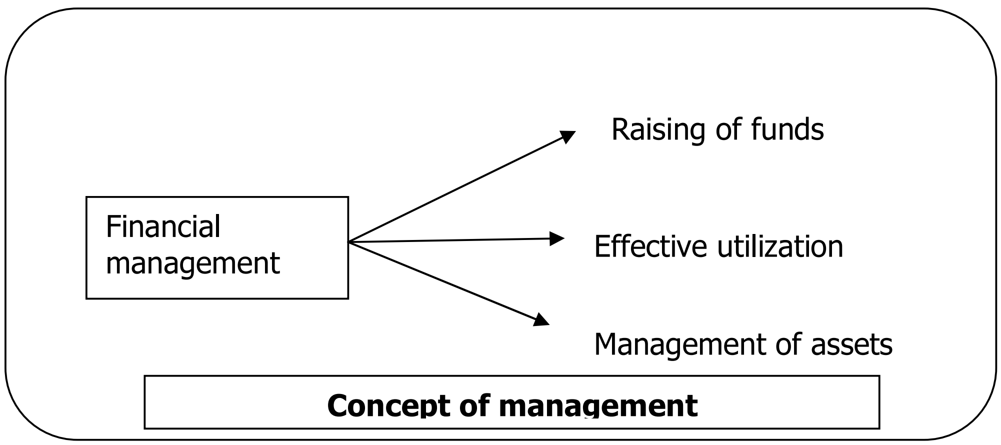
5.1 Financial management
• Introduction
• Objectives
• Functions
5.2 Capital generation and management
• Types of capitals
• Sources of raising capitals
5.3 Budgets and accounts
• Types of budgets
• Types of accounts
    ○ Profit and loss account
    ○ Balance sheet
5.4 Introduction to taxes
• Excise tax
• Service tax
• Income tax
• VAT
• Custom duty
	08	**08**

Q. what is financial management?

Finance is the effective procurement of funds and their effective utilization. Business finance is that business activity which is concerned with the collection and maintenance of capital funds in meeting financial needs to satisfy overall objectives of the business firm.

"Financial management is the study of relationship between the raising of finance and deployment of finance".

Financial management is thus concerned with maintenance and creation of economic wealth of business.



Concept of management

Q. what are the objectives and functions of management?

Objectives of financial management are:

1. Profit maximization
2. Wealth maximization
3. Maintenance of liquid assets
4. Fair return to shareholders

Functions of financial management are:

1. Conducting financial analysis to identify strengths and weakness of an organization.
2. Identifying opportunities and threats in future.
3. Deciding and planning the financial strategies.
4. Keeping the funds available whenever required with careful intention.
5. Ensuring financial discipline in the organization.
6. Keeping separate funds for growth and expansion.

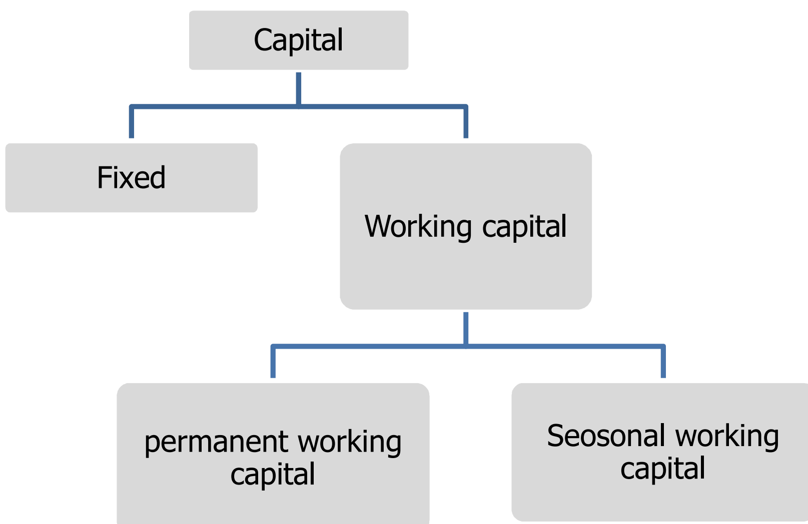
7. Planning and structuring the levels in returns to shareholders.
8. Conducting financial review, periodically.
9. Providing realistic data to higher management for decision making.
10. Taking care of accounting and budgeting.
11. Finding ways of raising more funds and investment of excess funds.

Q. Explain capital generation and management.

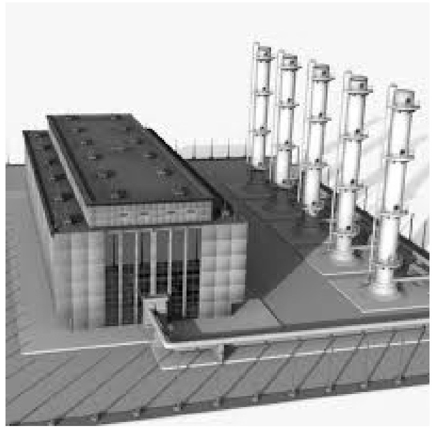
Capital generation and management is the most crucial part of any organization.

Types of capitals:

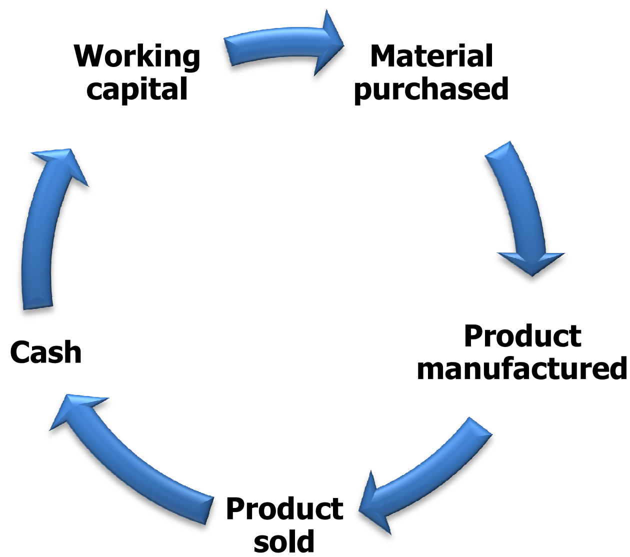
Capital is the measure of the amount of resources of an enterprise. It is the necessity of an enterprise all the time. It includes money, land, buildings, structures, machinery, materials etc.



1. Fixed capital: It is also called as block capital. It is required in the starting phase of industry. It is a large amount invested in land, plant set up, equipment purchasing, building constructions, machinery purchasing, furniture etc. once it is invested, and it becomes permanent asset. Fixed/block capital is required for items mentioned as: land, buildings, plant setup, internal roads, electric supply, water supply, sanitation arrangements, machinery, furniture, office setup and patents.



2. Working capital: Day-to- day functioning of an enterprise is possible through availability of working capital. It involves the use of short term funds in business. It is also called as circulating capital.



Working capital is required for expenditures mentioned as: material purchasing, payment/salary, maintenance cost, selling cost, advertisement expenses, transportation costs, any sudden expenses, cost of facilities and brand promotion expenses.

Types of working capital:

1. Permanent working capital: this is an obvious expenditure. Even though it is working capital, its nature is permanent every year or month. It is the minimum capital required for day-to-day functioning which is already known to the administration. E.g. payments, salary,

wages, minimum stock of raw materials, electric and telephone bills etc.

2. Seasonal working capital: this is the expenditure due to seasonal happenings. Sometimes unpredicted incidence happens which requires capital to be used. E.g. Bonus pay, sudden charges, accidental charges, special functions, international conference, special advertisement campaigns, expenditure due to change in government policies etc.

Advantages of sufficient working capital:

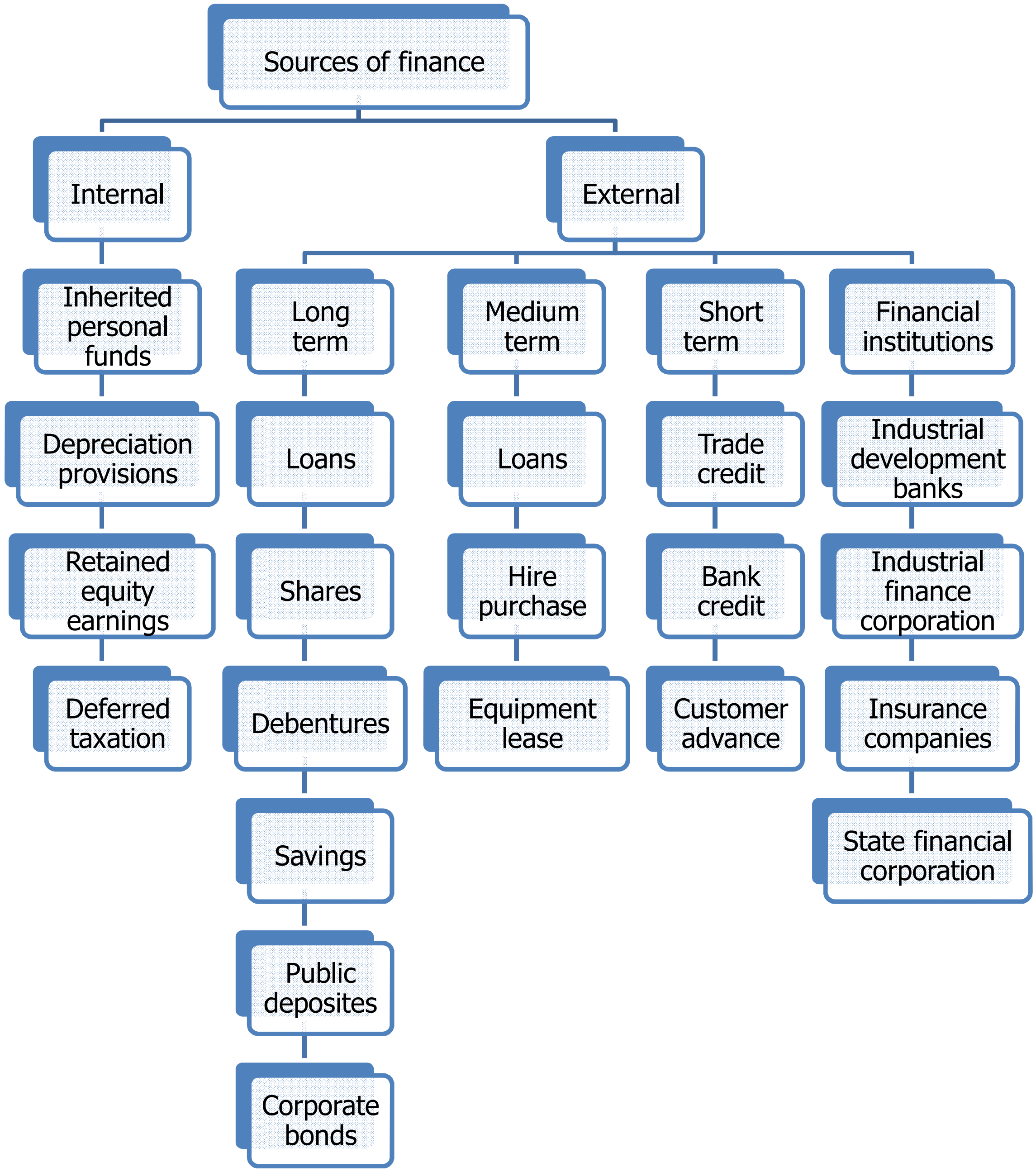
1. Production is continuous without stoppages.
2. Solvency of the company is maintained.
3. Vendors and suppliers are paid in time.
4. Availability of cash discounts.
5. Banks are ready to provide loans.
6. No emergency situation due to lack of money.

Factors affecting working capital:

1. Turnover of the firm.
2. Duration
3. Product value
4. Production method
5. Terms of purchase and sales
6. Inventory capacity
7. Urgency

Q. Explain various sources of raising capital.

Parents are source of finance to students. Sometimes education loans and scholarships are the sources of finance. The sources of finance to enterprise are given below.



Internal sources

1. Inherited personal funds:
   - Own investment is initially done.
   - Other sources then enter with their investments
2. Depreciation provisions:
   - It is provision against 'aging' of machinery.
   - Capital is kept aside from the starting phase only

- Due to this, there is no urgency when machines are older, under repairs or when they are to be replaced.

3. Retained equity earnings:
    - Reinvestment of earnings of shareholders.
    - This requires motivation of shareholders for reinvestment.
4. Deferred taxation: it is the postponement of the tax liability.

External sources:

A. Long term:

1. Loans: from commercial banks, from money lending institutions. Loans are paid back as per interest rates.
2. Shares: public invest money by purchasing shares of company.
3. Debentures: finance can be raised through debentures for a specific period.
4. Savings: Most of the investments in industry are due to savings of people.
5. Public deposits: deposits are accepted directly from public for fixed terms of period.
6. Corporate bond: investor invests money with claim on assets, in case of default.

B. Medium term:

1. Loans: from banks or money lending institutions.
2. Hire purchase: payment by periodic installments. So rest of the capital can be used elsewhere.

Hire purchase:

- When the buyer is unable to pay the full purchase price.
- Useful in acquisition of plant, equipment or longer life items.
- Hire purchaser pays an initial deposit to the supplier/finance house
- Item is then received.
- Hire purchaser then pays regular monthly or period wise payments.
- Hire purchase interest rates are high.

3. Equipment lease: high cost equipments are used on rental payment on lease basis. So rest of the capital is available to use elsewhere.

Finance equipment leasing:
- Another way to acquire high value items.
- The parties to the contract are:
    - Lessor (Financer)
    - Lessee (Who acquires goods)
- Items legally belong to the lessor
- But lessee is responsible for its maintenance and everything.

Lease can be helpful source of finance when:

The price of the asset is high relative to the financial resources of the potential user of the assets.

The useful life of the assets is in excess of the user's requirement.

The user may want to rest the asset before committing himself to its purchase.

The lease financing also has some limitations:

Sometimes, the terms of the finance lease may be inconvenient.

In case of a lease, the ownership and the title remain with the lessor or financer.

C. Short term:

1. Trade credit: Financial assistance by related business firms.
2. Bank credit: Money provided by banks on credit for short period.
3. Customer advances: Prior payment by customer before delivery of product.

D. Financial institutions:

1. Industrial development banks: These banks give loans to industries.

2. Industrial Finance Corporation: Long term and medium term credits are offered to industries in need.
3. Insurance companies: Money can be borrowed from insurance companies also.
4. State financial corporations: medium and small term loans to industries. These are working at state levels.

Share market:

It is also known as 'stock market' or 'equity market'. Shares are traded i.e. purchased or sold in stock exchanges. Share is the investment in joint stock companies. Share trading is done at agreed price. NYSE, NASDAQ, London stock exchange are the names of foreign share markets. BSE i.e. Bombay stock exchange is located at Mumbai. NSE (Mumbai), PSE (Pune), JSE (Jaypur) is also other stock markets in India.

Types of shares:

- Preference shares
- Ordinary shares
- Bonus shares
- Rights shares

Preference shares: They are preferential in several respects. They carry a fixed dividend. Of course, a company can only pay a dividend if it has profits available for distribution according to legal rules.

When a company goes out of existence, the preference shareholders receive upto the nominal amount of their holding, depending on availability of cash, before the ordinary shareholders receive anything.

The voting rights of preference shareholders are very restricted being limited to matters affects their rights.

Ordinary shares: it is also known as equity shares. Ordinary shareholders have one vote for each share they hold.

The dividends are not fixed. The dividend fluctuates with the fortunes of the company and the policy of directors.

Bonus shares: when a company has accumulated a large amount of profit which it has not distributed as dividend and which it wishes to retain permanently within the company, it may make a bonus issue. This involves converting the profit into ordinary share capital and distributing it to shareholders on a proportionate basis.

Rights shares: when a company wishes to raise more cash, one alternative is for it to make a rights issue. The shares are made available to existing shareholders, on a proportionate holding basis. They are available at a concession.

Advantages of equity share financing:

1. It is permanent source of funds.
2. The new equity share capital increases the corporate flexibility.
3. Equity share capital does not involve any mandatory payments to shareholders.

Limitations of equity share financing:

1. The equity share capital has the highest specific cost of capital among all the sources.
2. The dividends paid to shareholders are not tax deductible.

Advantages of preference share financing:

1. They carry limited voting right. So less interference and pressure of such shareholders.
2. Cost of capital of preference shares is less.
3. It helps to tackle in inflation situation.

Limitations of preference share financing:

1. in case of non-payment of preference dividend it causes adverse effects in the market.

2. Substantial cash outflow is thereafter 20 years due to redemption of preference shares.

Difference between shares and debentures:

Sr. No.	Shares	Debentures
(1)	Form part of the capital of company.	It is loan to company.
(2)	Shareholders are owners of the company.	Debenture holders are creditors of the company.
(3)	Shareholder enjoys all the rights of membership. e.g. vote in the meetings etc.	Debenture holders have no such rights.
(4)	Payment of dividend is given to shareholder.	Payment of fixed interest and return of principal is prior important payment than shareholder's dividend.
(5)	No charge on the assets to the share holders.	Debentures have a charge on the assets of the company.
(6)	Dividend on shares is paid only when the company has earned profits.	Interest is payable whether there are profits or not.
(7)	Dividends given to the shareholders may fluctuate from year to year as per profit.	Debentures carry a fixed rate of interest.
(8)	Shareholders can exercise control over the management of the company.	No control on affairs of the company.
(9)	Shares cannot be issued at a discount.	Debentures can be issued at a discount.

Q. Explain budgets and accounts.

BUDGETS AND ACCOUNTS

Budgets: Budget is the financial plan of the next year. It is an instrument of management for planning its future activities. Budget is the financial statement of how money will come and how it will go in business functioning. It represents financial requirements of various departments of the enterprise. Budget is nothing but a plan of action.

Characteristics of the budget:

1. Quantity and money may be the basis of the budget.
2. It is time bound.
3. It is prepared before the defined period of time commences.
4. It decides the objectives.

Budgetary control: when the budgets are used as a tool for planning and controlling the production system, it is called as budgetary control.

It is the important function of finance management. It is one kind of control on all financial activities. Here actual provisions in the budget and actual expenditure are compared and the control is operated to avoid extremities. Budgetary control helps to achieve the targets defined by the management in that financial year.

Objectives of budgetary control:

1. To decide a production volume.
2. To plan for the year.
3. To keep balance between expenditure and the provision in the budget.
4. To plan future income.
5. To analyse factors affecting unnecessary expenditures.
6. To effectively execute business policies

TYPES OF BUDGET:

(1) Fixed Budget: Capacity utilization is also called as Level of Activity. If this level of activity is fixed and if the budget is prepared based on this fixed level of activity, it is called as 'Fixed Budget'. Flexibility is zero and no provision for any change during the budget period. Fixed budget is established for a specific level of activity. It is not adjusted

to the actual level of activity attained at the time of comparison between the budgeted and actual results. Fixed budget is normally only for a short period of time. Fixed budgets are more suitable for fixed expenses.

(2) Variable budget:

- Any change in capacity utilisation is accepted and adopted.
- The level of activity is kept variable for that.
- It is called as flexible budget.
- It is designed to change with the fluctuations in the level of activity.
- It provides a basis for comparison for any level of activity actually attained.
- It is more elastic and practical.

(3) Appropriation budgeting: It is also called as conventional budgeting. It is applicable where measurement of output is difficult. Areas of uncertainty can be covered under this. In research and development, we can't expect number of inventions in a stipulated period. Also, in government plans of development in education, health, environment etc, we can't fix a number for performance measurement.

(4) Performance budgeting: It is applicable where performance measurement is easier. Annual targets are defined in terms of physical quantity or numbers. Plans are made accordingly. Here, we see the relationship between physical and financial aspects of programs and activities. It is effective in planning and controlling.

(5) Zero-based budgeting: It is not based on previous year’s records. Here critical analysis of every activity is done and based on realistic situation budget is prepared. The word zero means, our thinking has no history, it has nil base, it starts here only.

Advantages of zero-based budgeting:

(1) It ensures utility of each decision.
(2) No arbitrary adjustment involves. Cost and benefits analysis is the main basis.

(3) Wastages are avoided.
(4) Plans are made according to essential priority of the organisation.
(5) It concentrates on success in achieving goals of organisation.

Limitations of zero base budgeting:

(1) It consumes more time.
(2) Intelligent and properly trained managers only can prepare this budget.
(3) It is costly to prepare such a budget.
(4) Implementation is difficult.

(6) Production budget:

- It is done by a production head in assistance with his subordinates as well as concerned department heads.
- It starts from, how many products to be produced.
- Then total cost expected in producing this output is calculated. Cost calculation is done week-wise or month wise.
- It takes into consideration labour cost, material cost, manufacturing cost, maintenance cost etc.
- Due to availability of precise production budget, it is easier to plan the functioning of day to day activities.
- It is a forecast of production for the budgeted period.
- It may be prepared from two angles
    i. based on quantity
    ii. based on money
- It is prepared to assure that demands of sales department can be met.
- It is prepared by considering
    i. sales
    ii. demand
    iii. capacity of plant
    iv. economic lot size
    v. availability of lot size
    vi. budgeted stock requirements

Production Budget

For the Year Ended December 31, 20B

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Year as a Whole
Planned sales (Schedule 1)	1,000	1,800	2,000	1,200	6,000
Desired ending inventory*	180	200	120	300†	300
Total needs	1,180	2,000	2,120	1,500	6,300
Less: Beginning inventory	200†	180‡	200	120	200
Units to be produced	980	1,820	1,920	1,380	6,100

*10 percent of the next quarter's sales (for example, 180 = 10% × 1,800).
†Given.
‡The same as the previous quarter's ending inventory.

- Variance: The deviation of the actual from the standard is known as variance. The variance may be favorable or unfavorable.

Control of variance

Variances	Department to be held responsible
Price	Purchase
Grade	Stores, purchase, production
Rate	Production
Time	Production
Volume	sales
Efficiency	production
Expenditure	production

Cost Variance

Mon 15 Jan 2007 to Sun 11 Feb 2007 (28 Days)
Employees in Maintenance Ordered by Last Name

Maintenance

Number	Title	First Name	Last Name	Planned Hours	Actual Hours	Variance Hours	Planned Cost	Actual Cost	Variance Cost
102479	Mr.	Michael	Chauvin	51:00	38:45	-12:15	306.00	232.50	-73.50
104267	Mr.	Neal	Johnson	49:00	37:45	-11:15	294.00	226.50	-67.50
102466	Mr.	Timothy	O'Hara	37:00	40:30	03:30	185.00	202.50	17.50
108924	Mr.	Alex	Varia	63:00	49:45	-13:15	315.00	248.75	-66.25
				200:00	166:45	-33:15	1,100.00	910.25	-189.75
				200:00	166:45	-33:15	1,100.00	910.25	-189.75

(7) Labour budget:

- Man-hours are calculated from the production targets. Work-study, method study techniques are employed to find out the exact requirements of labours. Also our limitations of funds on labour wages must be taken into consideration. Labour budget implies the number of labours required department wise in the coming period.
- It tells about the estimates of labour requirement essential for carrying out the budgeted output.
- In the calculation of this, previous records may be referred.
- The budget may give details regarding direct labour costs only for both direct labour hours and cost.
- (Labour cost per unit) X (budgeted units)= estimated cost of direct labour.
- Direct labour budget may be divided into
    - i. Direct labour requirement of budget.
    - ii. Direct labour procurement budget.
- Determination of labour requirement:
    - i. Divide the production activity into operations.
    - ii. Find the requirement of standard time for each operation.
    - iii. Calculate total number of hours for the production activity.
    - iv. From this data find out the exact requirement of labours.

Preparation of labour budget

(1) Determine the number of labours required.

(2) Mention this requirement as per the grade.

(3) Mention number as per the grade requirement.

(4) Decide the standard rate.

(5) Find the cost values.

Jerry's Ice Cream
Direct Labor Budget
Year Ending December 31

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Year
Units to be produced*	40,800	49,200	59,200	51,200	200,400
Direct labor hours per unit	× 0.10	× 0.10	× 0.10	× 0.10	× 0.10
Total direct labor hours needed in production	4,080	4,920	5,920	5,120	20,040
Labor rate per hour	× $13	× $13	× $13	× $13	× $13
Total direct labor cost	$ 53,040	$ 63,960	$ 76,960	$ 66,560	$260,520
Direct labor cost per unit**					$ 1.30

(8) Sales budget: cost estimation of sales and revenue generation in sales are considered for sales budgeting. Requirement of advertisement, rates of advertisement, channels of market penetration, workforce required, final targets etc. are decided in sales budget.

(9) Cash budget: It is prepared for forecasting the possible cash receipts and payments over the budget period. Funds management and funds availability are possible by the cash budgeting. Finding ways of fund raising, investment plans and cash expenditures are necessary components in cash budgeting.

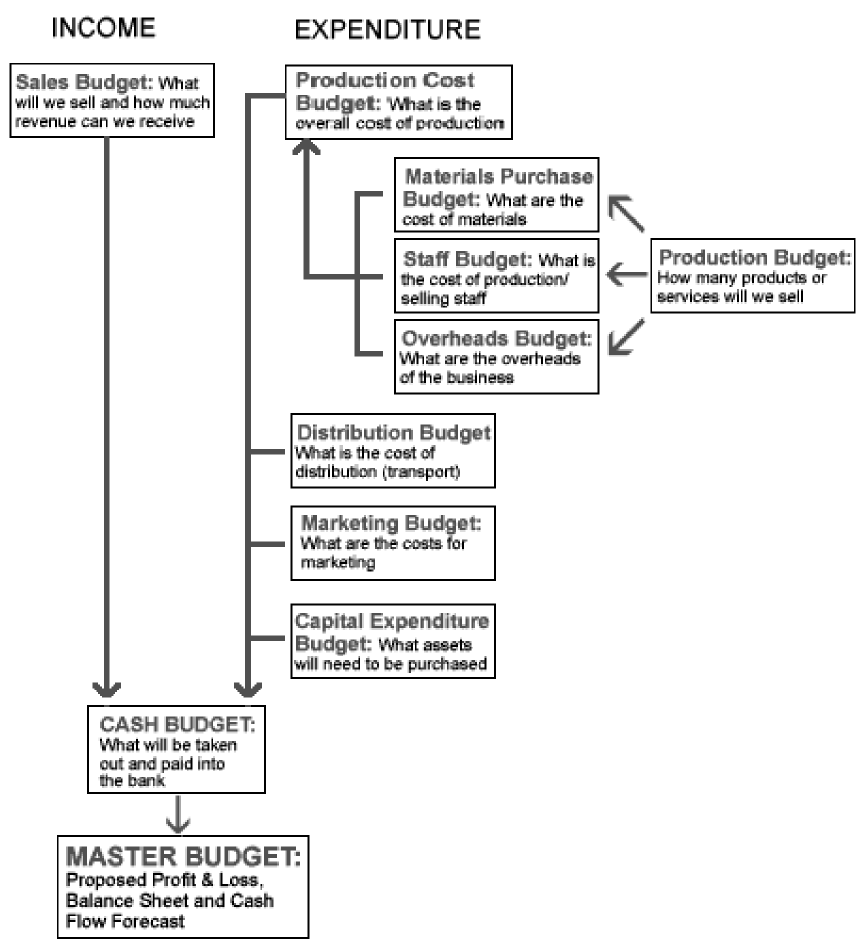
(10) Material budget: It is done by considering how much is the material required for our output production, how much material is already there in inventory and market status. Based on economic order quantity, overhead charges, inventory cost, rate fluctuations and type of material we decide about purchasing of material.

(11) Capital expenditure budget: Expenditure of purchases, capital investments, capital utility in new projects are the important aspects of capital expenditure budget. Due to this money is properly planned either expended or invested.

(12) Financial budget: It gives conclusive statement of how money will be received and how money will be spent during the budget period. Profits are decided and accordingly targets are planned. Status of

business at the end of the next financial year is forecasted and financial decisions are taken accordingly.

(13) Master budget: the summarised budget of the entire enterprise is known as Master budget. For bigger organisations, separate budget had together to form a big budget which is difficult to understand. So, summary is prepared for all the plans, policies, departments etc to form a Master budget. At a glance, all the details can be seen due to this.



Necessity of budgets:

(1) To check the performance responsibility.

(2) It helps to clearly understand financial position of the concern.

(3) Due to budget, there is check on the efficiency of industry.

(4) For getting loans from banks, budget is necessary.

(5) Due to budget, the policies for the coming period are formulated properly.

Q. Explain profit and loss account.

- It is the objective of most businesses to make a profit.
- They buy the resources, produce the product and sell it at such a price which returns them all their investment in the production as well as the cost of running business.
- The money left over after these have been paid, is profit.
- This profit can be utilized in any way as the owner desires i.e. to purchase new equipment, repay the loan, bonus to employees, investment in next activities etc.
- The profit and loss account is the financial document which shows how much profit was made during the last financial year.
- The earning capacity and potential of the firm are reflected in firm's profit and loss account.

Functions of profit and loss account:

1. It determines net profit or net loss.
2. It matches the revenue and expenses.
3. It provides the flow of economic data, flow of revenues and expenses in the given time period.
4. It projects the profitability of the industry.

Types of profit and loss account:

1. Step form: It may be single step or multi step. Single step form records all revenue items first and then the expenses items. The total expenses are subtracted from the total revenue to get the net income or net profit.
2. Account form: statement is divided into two vertical parts. The left-hand side is used to record expenses items. The right side is used for revenues.

Q. Explain balance sheet.

- The balance sheet is an important financial document.
- It lists all the different areas in which money is belonging to organisation.
- It also specifies the amount in each area.
- Since, money is constantly flowing around the organisation the balance sheet can only apply to one particular instant.
- The best conceptual understanding of the balance sheet is possible by thinking of it is a financial snapshot of the organisation.
- Because of this the balance sheet is prepared for a particular day, usually for the day on that ends the organisation's financial year.
- While doing assessment of organisation only balance sheet is not checked, but along with those other documents such as profit and loss account is also seen.
- It indicates the financial condition of a business at a particular moment of time.
- Balance sheet communicates information about assets, liabilities and owner's equity for a business firm on a specific date.

The balance sheet takes its name from the fact that it has to balance two amounts of money. It operates on the principle that if you have something it must have been paid for somehow. For instance, if you own a building you must have once had money with which you bought it. One side of balance sheet shows where the money came from and other side of sheet shows what has been done with it.

Procedure to make a balance sheet

1. Fill in the company name, statement name and date at the top of the balance sheet. Every financial statement lists the company's name, the name of which statement is being prepared and the date.
2. Classify each asset account the business has. Asset accounts are separated into different classifications, including current assets, investments, property and equipment, intangible assets and other resources. The balance sheet lists all assets of the business on the left-

hand side of the statement. The assets are listed in the order of liquidity. Each classification is listed by name and amount and has a total. After all assets are listed, a total of all classifications is placed at the bottom of the statement.

3. Place all liability accounts and amounts. At the top of the right side of the statement. Liability accounts are listed by classification in the order of current liabilities and long-term liabilities, which is the order of when they will be paid off. Each liability classification gets totaled, and then a total of all liabilities is placed below that.
4. Place all equity accounts and amounts below the liability section. They are listed in a specific order beginning with paid in capital, retained earnings then treasury stock. After all equity accounts are listed, a total is then calculated.
5. Add the liability total and equity total to get the bottom line for the right-hand side. When added up, this number should equal the total asset amount found at the bottom left side of the balance sheet.

Functions of balance sheet:

1. It provides conclusive statement of industry's resources and obligations.
2. It provides information about liquidity position of the firm.
3. Balance sheet indicates the solvency of the industry.
4. Balance sheet reflects the financial position of the firm.
5. It communicates information about resources, liabilities, owner's equity to creditors and others.

Types of balance sheets:

1. Account form: sheet is divided into two vertical parts. Right side lists the assets (resources) of the company. Left side shows the means by which assets have been financed (liabilities and owner's equity). The totals on both sides are equal.
2. Report form: a stepwise balance sheet is prepared. Assets are placed at the top. Liabilities and owner's equity are placed at the bottom.

Guidelines for both types of accounts:

The important provisions regarding the preparation of the above accounts are as follows:

1. The profit and loss account relates to the period:
    a. In the case of first annual general meeting-nine months before meeting.
    b. Any subsequent annual general meeting-six months before meeting.
2. At every annual general meeting of the company, the board of directors of the company shall lay before the company:
    a. The balance sheet as at the end of the accounting period.
    b. The profit and loss account for the period.

Profit and loss account and balance sheet are usually prepared at the end of the accounting period. Hence, there are also termed as final accounts of the company. Section 210, the companies act governs the preparation of the final accounts of any company.

Terminology in financial management

1. Journal:
    - It is used in accounting.
    - The Journal entry can consist of several items, each of which is either a debit or credit.
    - Journal accounting helps in understanding depreciation also.
    - Nowadays software is used to have entries in Journal.
2. Ledger:
    - It is the main file for recording monetary transactions by account department.
    - It has debits and credits in separate.
    - It shows a beginning balance and ending balance for each account.
    - Types of ledger:
        i. sales ledger
        ii. purchase ledger

iii. General Ledger

3. liability:
   - Meaning of liability is "something that someone is responsible for".
   - Liability includes:
     i. any type of borrowing
     ii. responsibility to others
     iii. already occurred transactions
   - A liability is a present obligation of the business arising from the past events.
   - Assets= liabilities+ owner's equity
4. Assets:
   - These are economic resources.
   - Assets represent ownership of value that can be converted into cash.
   - The major assets are tangible assets and intangible assets.
   - Buildings and equipment are included in fixed asset.
   - Inventory is included in current assets.

Adam Wesley's
Trading and Profit & Loss Account
for the Year ended December 31, 2010

	$	$	$
Sales		104520	
less Return Inwards		2950	
Net Sales			101570
Cost of goods sold:			
Purchases	91040		
less Return Outwards	5080		
Net Purchases		85960	
less Closing Stock		20180	65780
Gross Profit			35790
Add Revenue:			
Discount Received		11442	
Commission Received	4500		
Commission Received owing	1500	6000	17442
			53232
less Expenses:			
Electricity	1500		
less Electricity Prepaid	100	1400	
Telephone owing		1200	
Depreciation (fixture)[1]		96	
Discount Allowed		4510	
Rent		5000	
Wages		16000	28206
Net Profit			25026

Notes:
1. Depreciation per annum is pro-rated and hence the statements reflect depreciation for one month only.

LIABILITIES	Amount	ASSETS	Amount
Capital	XX	Fixed Assets-Land, Bldg,	XX
Loan taken	XX	Current Assets	
Current Liabilities		•Cash / Bank B/s	XX
•Outstanding Expenses	XX	•Accounts Receivable (Debtors)	XX
•Bank Overdraft	XX	•Bills Receivable)	XX
•Accounts Payable (Creditors)	XX	•Inventories (Stock)	XX
	XYZ		XYZ

Horizontal Form of Balance Sheet

Q. What do you mean by taxes?

1. The budget of government of India is divided into two parts
    - revenue budget and
    - capital budget
2. The revenue budget deals with collection of taxes.
3. Taxes are one kind of money payment to government.
4. Tax revenue comes from three sources:
    - Taxes on income and expenditure.
    - Taxes on property and capital.
    - Taxes on commodities and services.
5. The Indian Constitution has a three tier government:
    - Central government
    - State government
    - local self government
6. The tax revenue has recorded a considerable increase during the planning period.
7. India's tax structure is quite extensive.
8. Tax system is considered as a public finance.
9. India's tax structure is progressive in nature.
10. The aim of taxation is not only to collect money from people but it is too raise it from those sections of people who can bear the tax.

Powers of taxation under Constitution:

1. The central government gets tax revenue from:
    - Income tax (except on agricultural income)
    - Excise (except on alcoholic drinks)
    - Customs
2. The State government gets tax revenue from:
    - sales tax
    - excise from liquor and alcoholic drinks
    - tax on agricultural income

3. the local self governments e.g. municipal authority, get tax revenue from:
    - Entry tax (octroi)
    - House property tax

Q. Explain various types of taxes.

Texas can be classified by two ways

1. direct tax
2. indirect tax

And

1. Excise
2. service
3. income
4. VAT
5. Customs

Direct taxes: The impact and incidence of the tax are on the same person. It is not intended to be shifted. For example, personal income tax, corporation tax, estate duty, annual tax on wealth and gift tax.

Indirect taxes: the impact is on one person and the incidence is on another. A tax can be called an indirect tax if its burden can be shifted. For example customs duties, excise duties, sales tax etc.

Merits of direct taxes:

1. Equitable: there are more equitable as progression can be applied to them.
2. Economical: they are economical as the cost at collection is small.
3. Certain: the taxpayer is certain of the amount that he has to pay.
4. Elastic: they have high degree of elasticity.
5. Reduction of inequalities: they are used as an instrument for the reduction of economic inequalities.

Demerits of direct taxes:

1. Inconvenient: very inconvenient to pay.
2. Unpopular: direct taxes are very unpopular.
3. Evasion: they can be easily evaded.

Merits of indirect taxation:

1. Convenient: the taxpayer does not feel that he is paying the tax. We pay the tax when we buy a commodity, and at time when we can afford it. It is paid in small trickles rather than in a lump sum
2. No evasion: it is very difficult to evade an indirect tax, because it is mixed up with the price of the commodity one purchases.
3. Equitable: it is made equitable by being imposed on articles generally consumed by the rich. This is why luxury items are generally taxed at a higher.
4. Beneficial social effects: consumption of harmful drugs and intoxicants can be discouraged by heavily adding taxes on them.
5. Capital formation: indirect taxes are levied on the consumption of commodities.
6. Wide coverage: indirect taxes can be levied on a large number of commodities.

Demerits of indirect taxation:

1. Uncertain: they are uncertain. A finance minister and so cannot precisely calculate the estimated yield of tax.
2. Regressive: every customer of the taxed commodity, rich or poor, pays the tax at the same rate. So, real burden of the tax on the poor is greater than the rich.
3. Uneconomical: cost of collection of certain indirect taxes is very heavy.
4. Loss of economic welfare: taxation on commodities raises their price. The consumers suffer and the community suffers a loss of economic welfare.

Q. Explain excise tax.

1. It is commodity tax.
2. It is levied on production and has absolutely no connection with its actual sale.
3. Excise duties on commodities other than alcoholic liquors are levied by the central government.

4. Major revenue collection is from excise duties on textiles, sugar, tea, tobacco and cement.
5. At present, excise duties are levied by the central government in a number of forms.
6. Excise duties are applicable on commodities which are produced within the country.
7. Commodities which are levied under state government are exempted by central government.
8. Finance commission decides the formula for sharing of the tax between centre and State.
9. CENVAT is a value-added tax on manufacturers imposed by government of India. It is an improvement on central excise.
10. Excise is an indirect tax.
11. The central excise law is administered by the central board of Excise and Customs.
12. The country is divided into 10 dozens for the tax administration purpose.
13. Nature of Excise duty:
    a. The duty of Excise is not levied directly on the goods, but is levied on the manufacture or production of few commodities.
    b. Excise duty is payable by the manufacturer or producer, not by the consumer.
    c. The incidence of the duty is always, indirectly, on the consumer.
    d. The Levy and collection of excise duty is practically, made at a stage next to the manufacture of goods.

    Types of duties:

    1. Basic excise duty: excise duty, imposed under section 3 of the central excise and Salt act of 1944 on all excisable goods other than salt produced or manufactured in India, and the rates set forth in the schedule to the central excise tariff act, 1985, falls under the category of Basic excise duty in India.

2. Additional excise duty: section 3 of the additional duties of Excise act of 1957 permits the charge and collection of excise duty in respect of the goods as listed in the schedule of this act. This tax is shared between the central and state governments.
3. Special excise duty: special excise duty is levied on all excisable goods that come under taxation.

Excise duties applicable to: the liability to pay tax excise duty is always on the manufacturer or producer of goods. Example,

1. Manufacturing at own level.
2. Manufacturing by employing hired labour.
3. Manufacturing through outsourcing to other parties.

Q. Explain service tax.

1. The growth of the service sector in India during the last 10 years has been spectacular. Service sector accounts for nearly 50% of the country's GDP.
2. More than 90 specified services are now coming under service tax. This number was three in 1995.
3. Services are taxed on their production and sale.
4. Every passing year, new services are brought under service tax.
5. This tax is one of the fastest growing taxes for the central government.
6. Example: service tax is applicable to telephone, General, insurance, stock brokerage services etc.
7. Tax on services is an indirect tax.
8. Government of India had introduced the concept of service tax for the first time in 1994.
9. The basic aim has been to increase revenue as services constitute larger proportion in economy of India.
10. The person who provided the taxable service on receipt of charges is responsible for paying the service tax to the government.
11. The cost of goods and materials sold by the service provider to the receipt is excluded from the value of taxable service.

12. The service is offered abroad shall not be considered in the service tax.
13. The service tax is administered by the Central Excise Department.
14. This is not applicable to Jammu and Kashmir.
15. Service tax number is a 15 digit number which is allotted to the assessee at the time of feeling an application for registration of service tax.
16. Effective service tax rate is 12.36% in India including education cess and senior and higher education cess.

Advantages:

1. The government benefits because of the higher revenue collection on a wider tax base.
2. A large portion of the GDP contribution gets covered by this tax.
3. The taxpayers are not required to maintain any special accounts for the purpose of service tax.
4. No documents are required to be filled along with the return from except the details about the transactions.
5. The tax rate is quite low.
6. The procedure prescribed is very simple.
7. There cannot be many disputes about rate and valuation.

Disadvantages:

1. The service tax is regressive.
2. It is bound to affect all sections of the society.

Various services under service tax:

1. advertisement agency
2. telephone services
3. air travel agents
4. real estate agents
5. architects
6. banking and financial services
7. chartered accountants
8. broadcasting services
9. Company secretaries

10. video production agencies
11. Courier
12. photographic services
13. Security agency
14. Manpower recruitment agents.

Service tax is exempted to:

1. small service providers (turnover less than four lakhs per annum)
2. export services
3. suppliers to SEZ
4. Service is provided to UN.

Q. Explain Income tax.

1. Personal income tax is levied on the incomes of individuals.
2. For taxation purpose income from all sources is added.
3. This tax is levied by the central government.
4. The proceeds generated through collection of this tax, are shared between the Centre and States.
5. It is not on all people.
6. It is based on the principle of "ability to pay".
7. Certain people with low incomes are exempted from paying income tax.
8. The minimum exempted income has been changing from time to time.
9. During last two decades, there has been continuous reduction in the income tax rates.
10. It is now widely accepted that a moderate rates of income tax encourage savings.
11. An education cess of 2% on all taxes-including on personal income tax was levied.
12. It is a direct tax.
13. The nature and scope of tax liability:
    - Income tax shall be charged at the rate declared by the Finance act enacted every year.

- The law of assessment will be as per that law which is there on the 1st April of the year.
- Generally previous year income is considered for taxation purpose.
- The charge is on all persons

14. The Indian income tax act, 1922 is replaced in 1961.
15. Income tax act, 1961 has specified the following sources of income.
    - Salary
    - house property
    - business/profession profits
    - capital gains
    - Income from other sources.
16. The income tax is machinery for computing the total income of the previous year from various sources.

Q. Explain Value Added tax (VAT).

1. It is Value added tax.
2. VAT is modern and progressive form of sales tax.
3. VAT is simple and transparent to execute.
4. It is multipoint tax.
5. Tax incidence at each stage is reduced.
6. Taxes based on the amount of the value added at each case.

Benefits of VAT:

1. Overall tax burden is rationalized.
2. Prices will in general fall.
3. A set-off is given to tax paid on previous purchases.
4. Transparency increased.
5. There is higher revenue growth.
6. VAT is business friendly taxation.
7. It is eliminated “tax on tax” which was there in the previous sales tax.
8. So, reduction in the effective tax rate for many goods.
9. Tax structure becomes simpler.
10. Promotes competitiveness and exports.

Business liable for VAT:

1. importers
2. Manufacturers
3. distributors
4. Wholesalers
5. retailers
6. Works contractors
7. Lessors.

Rate of VAT:

1. 4% for items consisting mainly of raw materials used in manufacturing processes, IT products and other common consumption goods.
2. 12.5% for all goods unless they are listed under the other rates.
3. 20% for liquor.
4. 1% for gold, silver and precious jewelers.
5. Food grains, pulses, milk, vegetables and books are not subject to VAT.

How VAT is charged?

- The Ministry of Finance is the main agency for levying and implementing VAT, both at the Centre and State level.
- The state governments, through taxation departments are carrying out the responsibility of levying and collecting VAT.
- The central government is facilitator for the successful implementation of VAT.
- Haryana has become the first state in the country to introduce VAT.
- All registered dealers, regardless of where they are in the chain of manufacturing and production, must charge VAT on their sales of taxable goods and collect it from their customers.
- The Maharashtra Value added tax came into effect from 1st April 2005.
- VAT is a modern and progressive tax system now used in over 165 other countries.

Q. Explain Custom duty.

1. Indian tariff act, 1934 was modified in 1962 as 'Customs act, 1962'.
2. The new Customs act is a consolidation of the previous relating acts to sea, land and air Customs.
3. These are the taxes related to import export.
4. Duties are levied on commodities imported into India or exported from India.
5. So custom duties are of two types:
   - import duties
   - export duties
6. Import duties are generally and almost exclusively borne by the home consumer. The duty paid by the importer is added to the price that he charged from the next buyer.
7. Import duties have been relatively very productive.
8. There are heavy duties on imports of iron and steel, chemicals, drugs, medicals, fertilizers and petroleum products.
9. Central government levies both the custom duties.
10. Custom duties are third largest source of tax revenue to the Centre.
11. Customs duty perform two major functions:
    - generate revenue
    - regulate foreign trade
12. After 1991, there are significant reforms in the rules of customs duties.
13. The Customs act extends to the whole of India.
14. The customs duty initially started with 5% but at one point of time, the total burden of beauty was as high as 100% and in some cases more than 200% or300%.
15. Types of customs duties:
    - Basic custom duty
    - additional customs duty
    - special custom duty
    - Safeguard duty
    - protective duty

- export duty

16. stages in imposing of custom duty:
    - Levy
    - assessment
    - collection

    (a) Levy:
    - The declaration of liability is made.
    - Identification of items for taxation.
    - Charging of items

    (b) Assessment:
    - Amount of liability is quantified.

    (c) Collection:
    - Final stage in imposition of duty.

17. Goods on which customs duty is leviable:
    - vessels
    - aircrafts
    - stores
    - baggage
    - currency
    - movable property
    - goods that are imported or exported
    - goods specified in Customs tariff act

Helpful lines for online exam

1. **<u>Finance</u>** is the effective procurement of funds and their effective utilisation.
2. **<u>Financial management</u>** is the study of the relationship between the raising of Finance and deployment of Finance.
3. **<u>To ensure minimum funds utilisation, to decide investment policies and to finalise methods of financing</u>** are the objective of financial management.

4. This is not the type of capital
    a. fixed capital
    b. working difficult
    c. seasonal working capital
    d. **old capital**
5. Fixed capital is also called as **block capital.**
6. Building is coming under
    a. **fixed capital**
    b. working capital
    c. circulating capital
    d. none
7. Which is included under fixed capital?
    a. Plant set up
    b. water supply
    c. land
    d. **all**
8. Intellectual property is included under
    a. **fixed capital**
    b. working capital
    c. both
    d. none
9. Working capital is also called as **circulating capital.**
10. Working capital is required for
    a. advertisement
    b. salary
    c. maintenance
    d. **all**
11. minimum capital required for day-to-day functioning is called as
    a. block capital
    b. fixed capital

c. seasonal working capital

d. **permanent working capital**

12. Which cost is coming under seasonal working capital?

a. Accidental charges

b. bonus pay

c. International conference

d. **all**

13. Which is not the factor affecting working capital?

a. Inventory capacity

b. **land value**

c. urgency

d. turnover of the firm

14. Shares are included under **long-term** source of finance.
15. Debentures are included in **long-term** source of finance.
16. Which are long-term sources of finance?

a. Shares

b. loans

c. savings

d. **all**

17. Customer advances are included under **short-term** source of finance.
18. Hire purchase and equipment lease are included under **medium term** source of finance.
19. Depreciation provision is **internal** source of finance.
20. Which are included under financial institutions?

a. Industrial development banks

b. industrial Finance Corporation

c. insurance companies

d. **all**

21. Equity share financing is

a. **permanent source of funds**

b. temporary source of funds

c. both

d. none

22. statement 1-shares from the part of the capital of company

Statement 2- Debenture is loan to company

a. both 1 and 2 are wrong

b. 1 is correct,2 is wrong

c. **Both 1 and 2 are correct**

d. 1 is wrong,2 is correct

23. Statement 1-shareholders are owners of the company and statement 2-Debenture holders are creditors of the company.

a. Both 1 and 2 are wrong

b. 1 is correct, 2 is wrong

c. **Both 1 and 2 are correct**

d. 1 is wrong, 2 is correct

24. Which statement is wrong?

a. Debentures carry a fixed rate of interest.

b. **Interest is payable only when there is profit.**

c. Debentures holders have no control on affairs of the company

d. all

25. Budget is a financial plan for the **next year.**

26. About budget, which statement is wrong?

a. **It is not time bound**

b. quantity of money are the basis

c. it defines policies

d. It is prepared before the period.

27. Budgetary control is the important function of **finance management.**

28. Production budget is based on----

a. Flexibility

b. **Function.**

c. Mechanism

d. none

29. Labour budget is based on--

a. flexibility

b. **function**

c. mechanism

d. none

30. Fixed the budget is based on

a. **flexibility**

b. function

c. mechanism

d. none

31. flexibility is zero in

a. **fixed budget**

b. production budget

c. Labour budget

d. cash budget

32. fixed budget is for---

a. variable period

b. **fixed period**

c. both

d. none

33. zero-based budgeting is based on

a. flexibility

b. function

c. **mechanism**

d. none

34. ----is not based on previous year's records.

a. **Zero-based budgeting**

b. variable budgeting

c. production budgeting

d. none

35. Which statement is wrong?- Zero-based budgeting:
    a. is difficult to implement
    b. **consumes less time**
    c. avoids wastages
    d. is costly
36. Production budget is not prepared on--- angle.
    a. Quantity
    b. money
    c. quality
    d. **both (a) and (b)**
37. production budget is prepared by considering
    a. sales
    b. economic lot size
    c. capacity plant
    d. **all**
38. The deviation of the actual from the standard is--- in budget language.
    a. Variance
    b. change
    c. **difference**
    d. none
39. for making Labour budget workers are classified into
    a. skilled
    b. semiskilled
    c. unskilled
    d. **all the above**
40. The summarised budget of the entire enterprise is known as **Master budget**.
41. The earning capacity and potential of a firm are reflected in
    a. balance sheet
    b. **profit and loss account**
    c. both
    d. none

42. Profit and loss account is—

1. A flow statement.

2. A measure of firm's profitability

   a. **Both 1 and 2 are correct**
   b. Both 1 and 2 are wrong
   c. 1 is correct, 2 is wrong
   d. 1 is wrong, 2 is correct

43. Which is not the type of profit and loss account?

   a. Step form
   b. account form
   c. **report form**
   d. none

44. -- is the financial snapshot of the organisation.

   a. **Balance sheet**
   b. profit and loss account
   c. snap sheet
   d. budget

45. In balance sheet, we see,--- equal to the sources of funds.

   a. Expenditure
   b. **assets**
   c. savings
   d. liabilities

46. collection of taxes is concerned in

   a. capital budget
   b. **revenue budget**
   c. both
   d. none

47. **Tax revenue comes from income, property and commodities**.

48. India's tax structure is **progressive** in nature.

49. Central government is not dealing with **sales tax.**

50. Excise from liquor and alcoholic drinks is under
    a. **State government**
    b. Central government
    c. local self-government
    d. all
51. customs is the responsibility of
    a. State government
    b. **Central government**
    c. local self-government
    d. all
52. Which is direct tax out of following?
    a. Personal income tax
    b. Corporation tax
    c. estate duty
    d. **all**
53. Which is not the direct tax?
    a. Income tax
    b. Corporation tax
    c. gift tax
    d. **excise duties**
54. Which is indirect tax?
    a. Customs
    b. Excise
    c. sales
    d. **all**
55. Which is not the merit of direct tax?
    a. Equitable
    b. elastic
    c. **convenient**
    d. reduction of inequalities

56. which is not the merit of indirect tax

a. convenient
b. equitable
c. wide coverage
d. **certain**

57. match the pairs

a. Excise 1. Income of individual

b. Customs 2. Levied on production

c. income tax 3. Amount of value-added

d. VAT 4. Imports

a. **a-2,b-4,c-1,d-3**
b. a-1,b-2,c-3,d-4
c. a-3,b-1,c-2,d-4
d. a-4,b-1,c-3,d-2

58. Which is the type of excise duty?

a. Basic
b. special
c. additional
d. **all**

59. following service is not under service tax

a. Courier
b. Telephone
c. banking
d. **export services**

60. VAT started in Maharashtra from **2005.**