

BANKS & TAXES



A module from the book
Social Studies



AN EKLAVYA PUBLICATION

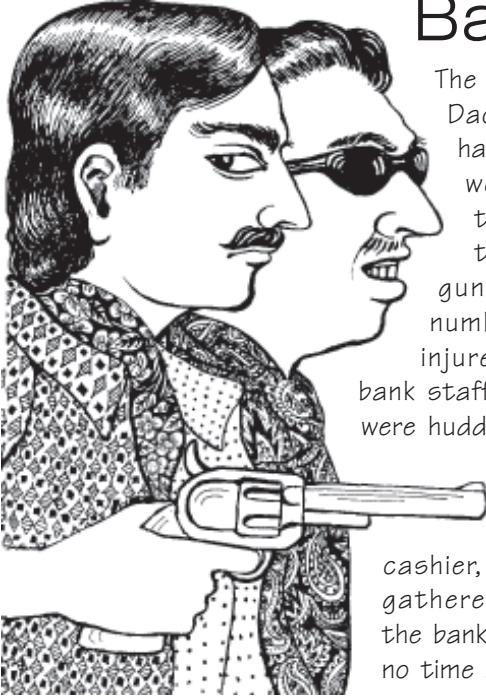
CHAPTER 1



Banks

*You must already know something about banks.
Write a paragraph on how people use banks.*

A Robbery at the Bank

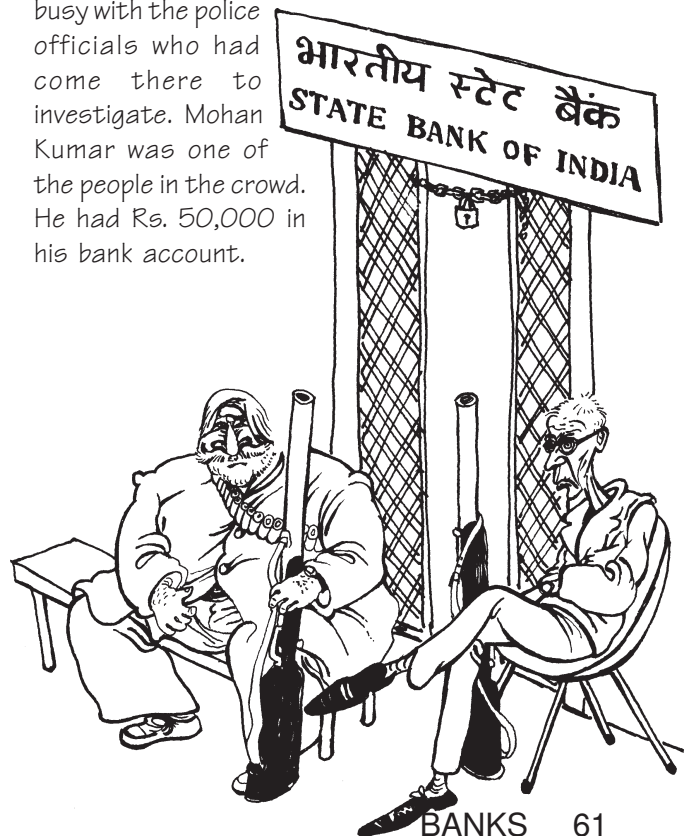


The bank had been robbed! Dacoits armed with guns had raided the bank. There were six or seven of them, so even though the guards also had guns, they were outnumbered. One guard was injured in the attack. The bank staff and some customers were huddled into a room with a pistol pointed at them. Meanwhile, threatening to kill the cashier, the dacoits hurriedly gathered all the money from the bank safe. It was all over in no time and they fled in a jeep.

Hearing news of this daylight robbery at the bank, many people grew worried and distraught. After all, so much of their money was deposited in the bank! One had 50,000 - another, 2,00,000. Many others had savings of 4,000 to 5,000 rupees.

Some of them thought that they would never get their money back now. They were under the impression that all the money they had deposited was stored in the bank's safe, and now it was gone. As news of the robbery spread in the small town, people started gathering at the bank. They were discussing how they had lost all their money.

Others disagreed, saying it was the bank's responsibility. They demanded their money back. They wanted to meet the manager but she was busy with the police officials who had come there to investigate. Mohan Kumar was one of the people in the crowd. He had Rs. 50,000 in his bank account.



He overheard the manager asking the cashier, "How much cash (notes and coins) was taken?"

The cashier said that the safe had Rs. 1,00,000 in it. Mohan was puzzled. His account alone had Rs. 50,000, so how could the safe have only Rs. 1,00,000 in it? If the amounts in all the depositors' accounts were added up, it would be a huge sum. Yet there was only this much money in the bank safe? What had happened to the rest?

What do banks do with people's money? How do banks function? This is what we'll discuss in this chapter.



Money Transactions

Anytime money changes hands from one person to another we say a **transaction** has occurred. Now we'll find out about different kinds of transactions that occur when people use banks: **deposits** (putting money in banks), **withdrawals** (taking money out of banks) etc.

Depositing Money in a Bank – Types of Bank Accounts

Teachers, shopkeepers, farmers, traders, officers, doctors, lawyers, schools, companies - all kinds of people and organisations open accounts in banks and deposit their money in them. People have different reasons for keeping their money in a bank.

Savings Accounts

Some people want to deposit money in a bank to safely save it for future needs. They do not need to withdraw money daily, only once in a while. For such people, banks have **Savings Accounts**.

People's money remains safe when it is deposited in a Savings Account. In addition, the bank pays them **interest** on their money – after a specified time, the bank adds a small percentage of money

to the account. There are, however, some restrictions in this type of account. For instance, there is a rule that in a Savings Account, money cannot be withdrawn more than 50 times in half a year.

Current Accounts

Other people, like shopkeepers and traders, have daily earnings that they like to deposit in a bank to keep the money safe. They also frequently withdraw money according to their needs. This could be to buy goods, pay labourers, or whatever. Similarly, large business offices have a daily inflow of money from customers who purchase their goods and services, as well as a daily outflow of money to people who have supplied them with various things or who have done some work for them. For these kinds of commercial needs, banks have a type of account called a **Current Account**. Many organisations and business people use this kind of account. There are no restrictions on the number of times you can deposit or withdraw money from a Current Account. However, the bank does not pay any interest on money deposited in a Current Account. The bank may even charge some fees for using a Current Account.

Fixed Deposit Accounts

Sometimes people may decide that they do not need to use a certain amount of their money for many months or years. They just want to save it, without withdrawing any of it for a long time. They can deposit this money in a **Fixed Deposit Account** (also called a **Term Deposit Account**) for a specified period of time. After the specified number of months or years has passed, the bank pays them their original money plus a fixed amount of interest. For this type of account, the rate of interest paid is greater than for a Savings Account. The interest rate is higher for accounts that specify longer fixed periods of time for the deposit.

The interest paid by banks does change from time to time. There may also be some differences in the interest rates among different banks. Go to a bank and find out:

- What is the rate of interest on a Savings Account?
- What is the rate of interest for a five year Fixed Deposit?
- If someone needs money urgently, how can they withdraw money from a Fixed Deposit Account?

What kind of account can be opened for the purpose of trade and business? What are the differences between this account and a Fixed Deposit Account?

Give three reasons why people may want to deposit their money in banks.

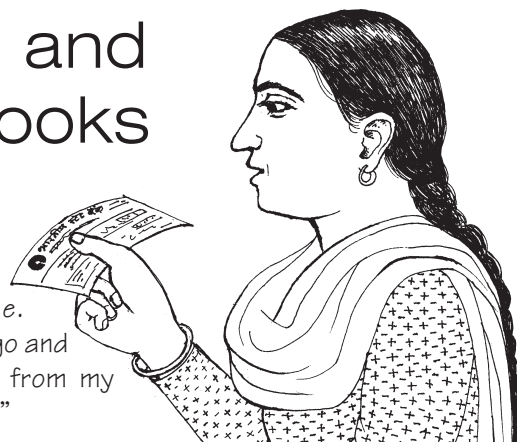
Withdrawals and Other Transactions

People can withdraw the money they have deposited in a bank on demand, i.e. whenever they choose to do so. This is because it is their money, which the banks are keeping as a deposit, so the banks must pay them whenever they want to withdraw it. However, there are certain rules and procedures to be followed. There are three common ways of withdrawing money from an account - through a withdrawal form, through a cheque, or (in some places) through an ATM (Automatic Teller Machine).


Using Withdrawal Forms and Passbooks

One day some money was needed at Rajinder's home.

She thought, "I'll go and get some money from my Savings Account."



Her account was in the State Bank of India. On reaching the bank, she asked for a withdrawal form. She filled it up, as shown below:

अपरकार्य Not Negotiable	 भारतीय स्टेट बैंक STATE BANK OF INDIA	खाता धारक का (के) नाम Name of the Account Holder(s) <u>Rajinder Kaur</u>
		बचत खाते से पैसा निकालने का फॉर्म SAVINGS BANK WITHDRAWAL FORM
आदेश Initials	सावधानी : यह बचत बैंक निकासी आदेश फार्म चेक नहीं है, इस फार्म के साथ पास-बुक रहना अनिवार्य है, अन्यथा भुगतान प्राप्त नहीं होगा। CARE : This form is not a cheque. Payment will be refused if the pass book is not produced with this form.	तारीख/ DATE <u>8/5 2003</u>
	कृपया केवल मुझे/हमें अदा करें/PLEASE PAY SELF/OURSELVES ONLY	बही/खाता क्रमांक Ledger/Account Number
लेजर/खाता क्रमांक Ledger/Account No.	रुपये/Rupees <u>one thousand and five hundred only</u> AND DEBIT THE AMOUNT TO MY/OUR ABOVE SAVINGS BANK ACCOUNT	₹ <u>1500/-</u>
	टोकन क्र. Token No.	रोकड़ अदा करें/Pay Cash
	सारणी क्र. Scroll No.	<u>Rajinder Kaur</u> खाता धारक का (के) हस्ताक्षर Signature(s) of the Account Holder(s)
आर० एफ० 10/R.F. 10		Item Code No. 3010139

Rajinder handed the filled up withdrawal form to the clerk sitting behind the counter. The clerk asked for her passbook. The clerk asked for her passbook, but Rajinder had forgotten it at home. She said to the clerk, "You know me quite well. Why don't you give me the money?"

To which the clerk replied, "Oh, that is impossible. It is a rule of the bank that the passbook **must** be shown with the withdrawal form." This is a sort of proof that the genuine deposit-holder is withdrawing money. Even if you know someone personally, you have to follow the rules. You can read the rules on the withdrawal form.



Rajinder noticed that the woman was using a different kind of form. The woman said, "This is a cheque. With my kind of Savings Account, I get cheques. It isn't necessary to have the passbook with you if you use a cheque."

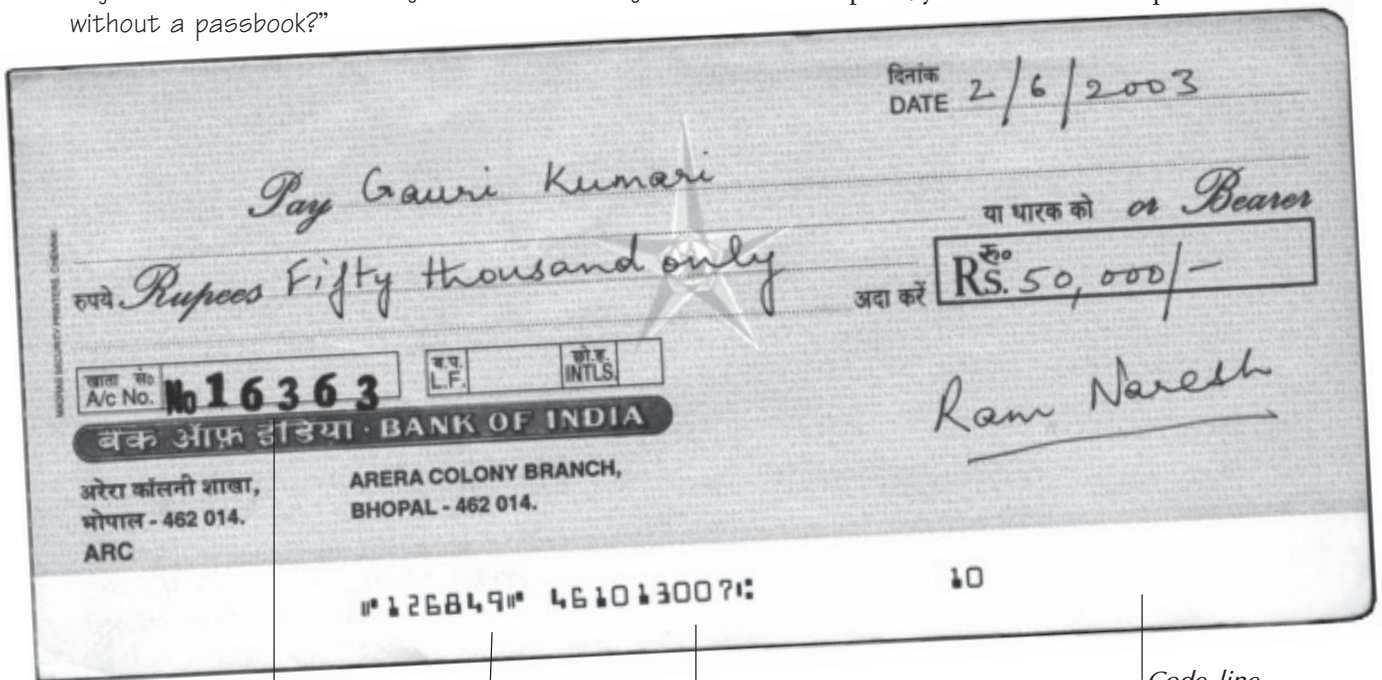
Discuss this incident with your classmates. Do you think the clerk was right to insist on following the rules? Why did the bank have this rule? Is it for the good of the bank or for the good of the account holder?

What is a passbook and what is its use?

Cheques - a convenient way to exchange money

Rajinder went home and came back with her passbook and was able to withdraw money. But standing next to her was a woman who was withdrawing her money without a passbook. Rajinder asked her, "How did you withdraw money without a passbook?"

These days cheques are widely used for both making payments and receiving money. Not only can you withdraw money from your account with cheques, you can also give cheques to others. When you want to give money to someone, you can write a cheque with that person's name on it. When you want to send money to someone who lives in a different place, you can write a cheque and send



Account number

Cheque number

Bank code

Code line

it by post. For business purposes, where money is frequently received and paid, the cheque is a very important medium for monetary transactions.

Look at this example of a transaction by cheque. Ram Naresh is a major trader of Bhopal and Gauri Kumari is the owner of a factory there. Ram Naresh has an account in the Bank of India, while Gauri Kumari's account is in the Punjab National Bank. Ram Naresh had to give Gauri Kumari Rs. 50,000. So he wrote out a cheque in her name.

On the cheque is written: "Pay Gauri Kumari or Bearer Rupees Fifty Thousand Only". The cheque reaches Gauri Kumari. She has two options.

If she wants the money in cash, she can go and encash the cheque by presenting it at Ram Naresh's bank (Bank of India, Arera Colony, Bhopal). The bank staff will check to be sure Ram Naresh's signature on the cheque matches the one they have in their record. They will also check to be sure there is enough money in Ram Naresh's account for the payment to be made. Then they will give Gauri Kumari the money in cash and will subtract Rs. 50,000 from Ram Naresh's account.

Gauri Kumari could do another thing instead. She could deposit the cheque in her own bank account. Then, her bank (that is, Punjab National Bank) will send the cheque to Ram Naresh's bank. His bank (Bank of India, Bhopal) will match the signature and check the account and then pay ('settle accounts with') Gauri Kumari's bank. Ram Naresh's bank will subtract Rs. 50,000 from his account while Gauri Kumari's bank will add Rs. 50,000 to her account.

Different people give cheques which each bank needs to collect from other banks. Now how do you think each bank gets money from the

other banks? In many towns and cities, representatives of all the banks meet on each working day to settle what each bank has to pay and receive from all the others. Each bank has an account in the Clearing Bank where they meet. All the banks then give or receive payments from each other (in the form of cheques from their accounts with the Clearing Bank). This is how banks clear cheques between themselves.

Thus, money transactions between people can take place without cash being exchanged.

In the beginning, there was Rs. 65,000 in Ram Naresh's account and Rs. 60,000 in Gauri Kumari's. After the cheque is deposited in the bank, how much money will there be in each account?

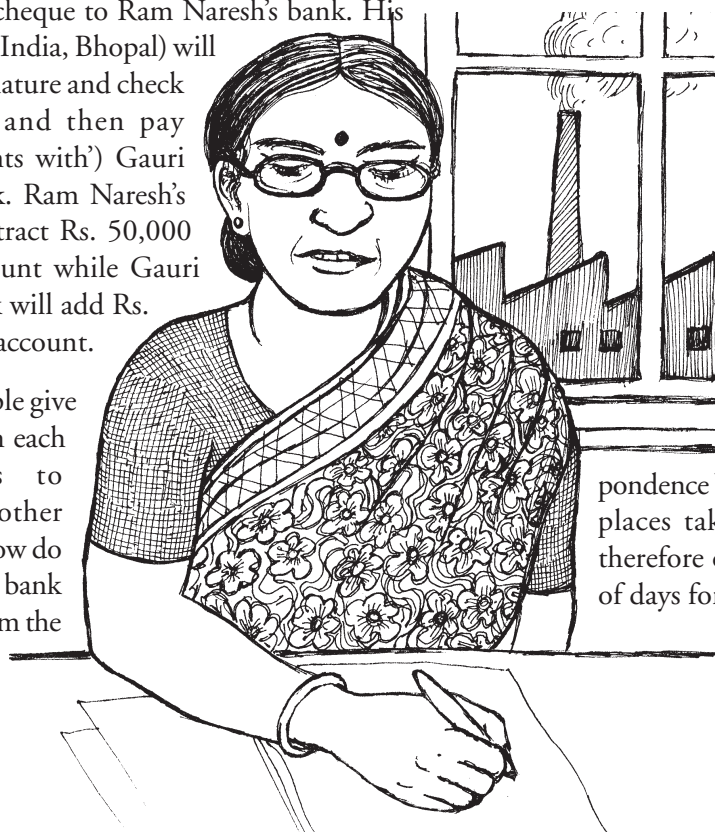
Explain how this transaction was done without actually handling cash.

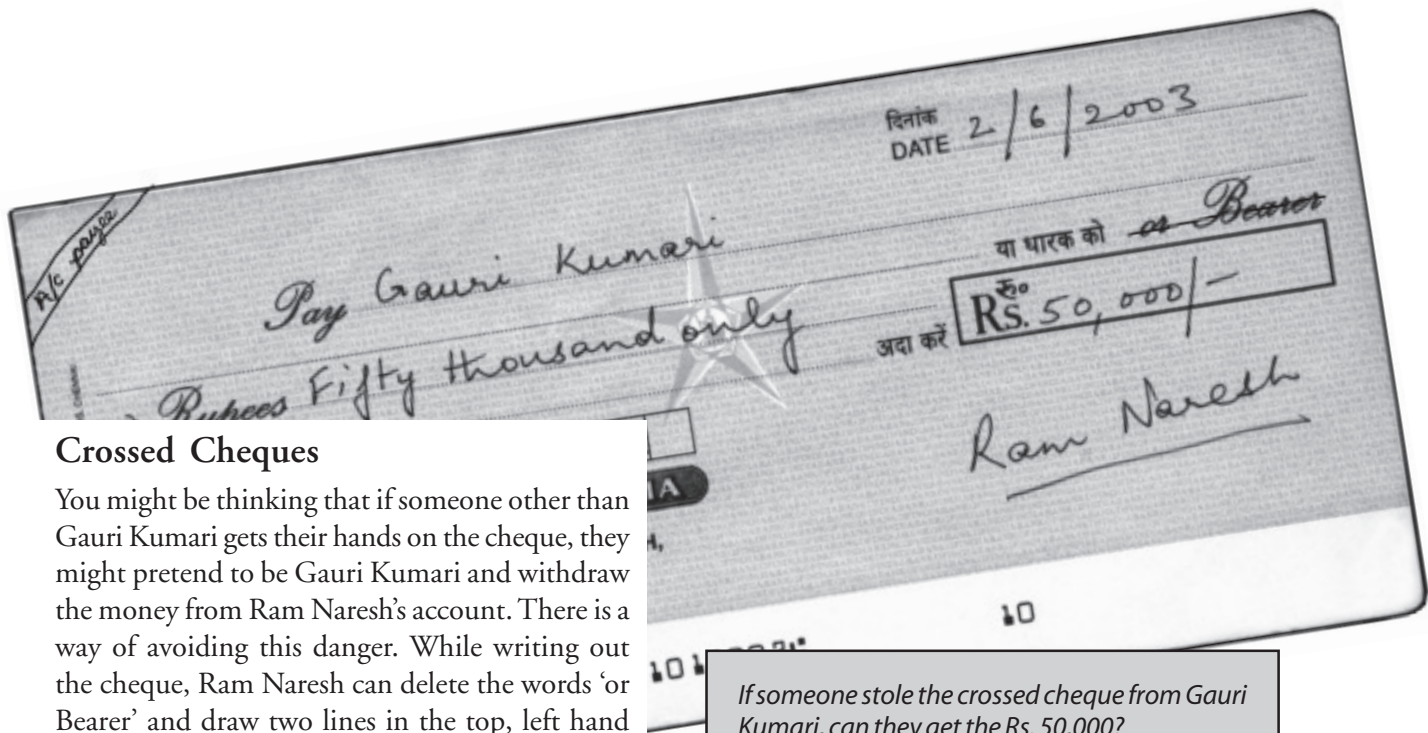
Who checked Ram Naresh's signature on the cheque, and why did they check it?

Come up with a skit with your classmates to show how a Clearing Bank works.

Why is a passbook not necessary when you use a cheque to withdraw money?

If Gauri Kumari was in Dewas and not in Bhopal, she would adopt the second option. That is, she would deposit the cheque in her own bank account. In such a situation both the banks would have to correspond with each other to verify if the cheque should be accepted. After that, the same procedure is followed as above. However, the correspondence between two banks at different places takes place through post and therefore one has to wait for a number of days for the cheque to be cleared.





Crossed Cheques

You might be thinking that if someone other than Gauri Kumari gets their hands on the cheque, they might pretend to be Gauri Kumari and withdraw the money from Ram Naresh's account. There is a way of avoiding this danger. While writing out the cheque, Ram Naresh can delete the words 'or Bearer' and draw two lines in the top, left hand corner, as shown above. Such a cheque is called a **crossed cheque** or an **account payee cheque**. When a cheque is crossed, it cannot be directly exchanged for cash – it must be deposited in the account of the person in whose name it is written. Gauri Kumari can receive the money only by depositing the cheque in her own account.

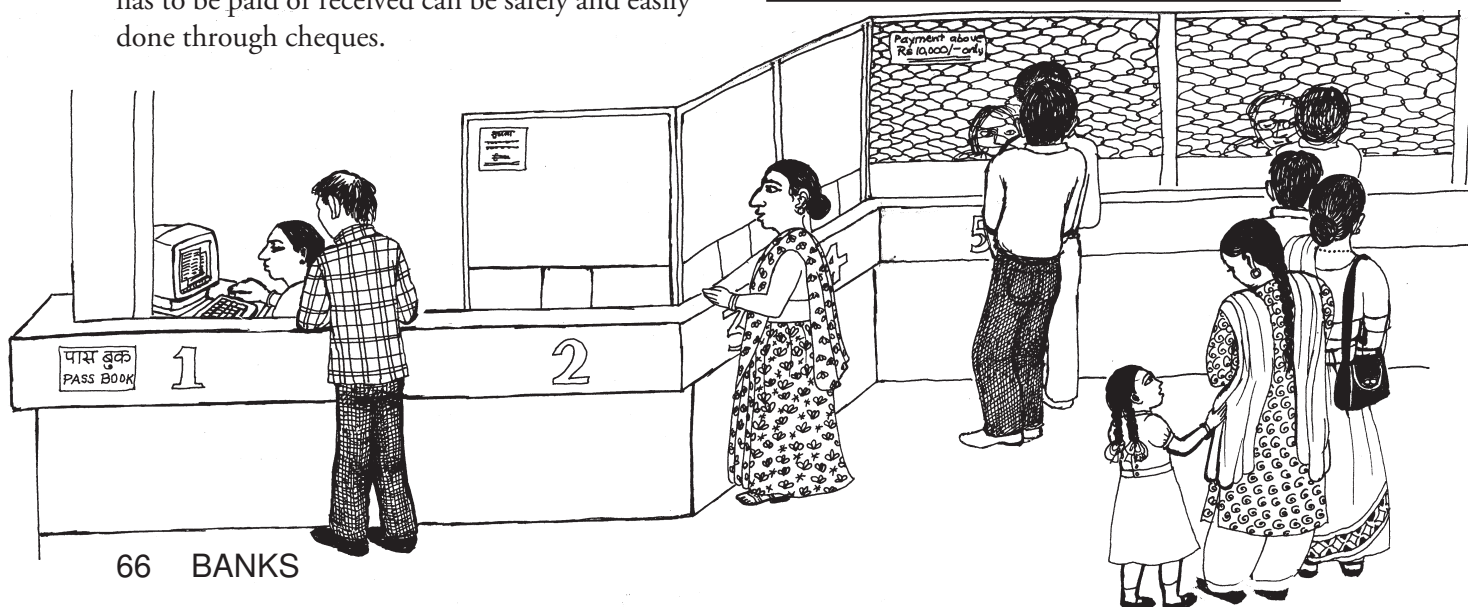
A crossed or account payee cheque is a good way to exchange money. By and large, transactions involving large sums of money take place only through crossed cheques. This way people can avoid the difficulty and danger involved in keeping or carrying bundles of notes.

This is one reason why it has become common for people to use banks. It is not necessary for people to keep their money in cash. It can remain as deposits in a bank account and whatever money has to be paid or received can be safely and easily done through cheques.

If someone stole the crossed cheque from Gauri Kumari, can they get the Rs. 50,000?

You have now heard about several ways of making payments and receiving money. Compare the convenience, safety and other advantages and disadvantages of making transactions with (1) cash, (2) bearer cheques, and (3) crossed cheques. For each of these three methods, give an example of a case where it would be the best way of making or receiving a payment.

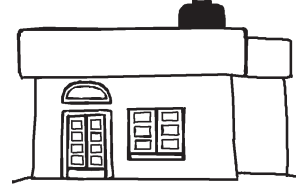
In last year's textbook, there was a skit about how money, in the form of coins, helped in a situation where barter deals were not possible. Do you remember it? Look at pages 139-141 of Social Studies, Class 7. Suppose, in that situation, instead of coins there was a bank and all transactions took place through cheques. How would the problem be solved? Write a new ending to the skit in which transactions are done through a bank.



Noting Transactions in an Account

Phool Singh's account is in the Timarni Branch of the State Bank of India. He is a farmer. He has sold soyabean to Chhagan Lal. Chhagan Lal has given him a cheque for Rs. 5,000. There was Rs. 7,000 in Phool Singh's account. After depositing Chhagan Lal's cheque there will be a balance of Rs. 12,000 in his account.

Given below is the table from Phool Singh's passbook. Copy it in your notebook. Fill the details in the table till the point where Chhagan Lal's cheque has been deposited.



Phool Singh's Passbook:

Sr. No.	Description	Money withdrawn	Money deposited	Balance
1	Money in Phool Singh's account			7,000
2	Cheque received from Chhagan Lal			
3				
4				
5				

Phool Singh was building a house. He needed to buy cement for the house. The cost of cement was Rs.8,000. He gave the cement stockist, Komal Gupta, a cheque for Rs.8,000. She deposited the cheque in her account.

There were labourers working on Phool Singh's house. He needed Rs.2,000 in cash to pay them. He withdrew this amount from the bank.

Fill in the details of the money paid by Phool Singh to Komal Gupta by cheque and the money withdrawn to pay the labourers, in the appropriate places in the passbook.

After each of these payments, how much money was there in Phool Singh's account? Fill the balance in the appropriate places in the table.

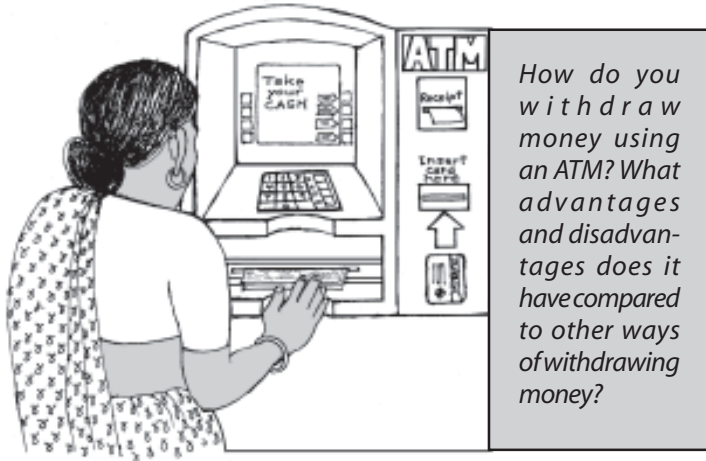
A BANK'S PROMISE

If a person has a deposit in a bank, then it is the duty of the bank to accept any demand for withdrawal of money in cash, or payments made by cheque. However there are many rules and procedures to be followed, especially to ensure that fraudulent methods are not used. At the same time, it is the account holder's responsibility to ensure that there is enough money in their account to cover the amount of whatever withdrawal is requested. For example, suppose you write a cheque for an amount that is more than the balance in your account. The cheque will **bounce** – it will be returned to you, and you may even be punished according to the rules agreed upon when you opened your account with the bank.

Electronic Banking

With the use of computers and electronic communication, many new ways of conducting money transactions are being devised. Some banks are fully computerised and do not use passbooks anymore. Instead, the bank gives a computer printout of the transactions and balance in the account whenever the account holder requests it.

Nowadays most cities and even some small towns have **Automatic Teller Machines (ATMs)**. These are machines that people can use to withdraw cash from their bank accounts, find out their balance, and, in some cases, also make deposits.



How do you withdraw money using an ATM? What advantages and disadvantages does it have compared to other ways of withdrawing money?

Find out whether banks in your area are using computers, and if so, how computers have changed the way they operate. Are there any other recent changes besides the ones we have already mentioned?

Instead of paying in cash or by cheque, some employers pay their workers by depositing money directly into their employees' bank accounts. Assuming that the employer and employee have accounts in the same bank, the employer has to just instruct the bank to transfer the correct amount to the employee's account.

You read about Clearing Banks, where representatives of different banks clear the cheques issued against each other. In the newer systems, representatives do not even have to meet. Transactions between one bank and another can be done through the banks' interconnected computers. This makes the whole system operate at a much faster speed than ever before. In our country this modernisation process has started and most banks are now computerised. We will witness rapid changes in banking in the years to come.

How do Banks Work?

You read about the bank robbery in the beginning of the chapter and how Mohan Kumar was puzzled that there was very little cash in the safe, compared to the total money of all the depositors. Like many people, he thought that all this money must be kept in the bank's safe. But it wasn't. So how do banks work?

Banks promise to pay cash to depositors on demand. But there are numerous account holders in a bank. It never happens that all the depositors turn up at the same time to withdraw all their money. Suppose there are 2000 account holders in a bank. On any given day 25 to 50 people might come to withdraw cash. Many people will withdraw money at the beginning of the month. If many of the depositors are farmers, then there will be a greater demand for cash during certain seasons. Every day only a limited number of people come to withdraw cash, and some also make deposits. With some experience, banks are able to estimate how much cash people will withdraw and how much they will deposit each day. The bank arranges to have the necessary amount of cash available.

Banks can fulfil their promises by keeping only a small fraction of their total deposits as cash. They can use the rest of the money that is deposited in their accounts for other purposes.

There is another reason why banks do not need to keep a large amount of money in cash. As you saw in this chapter, a great number of transactions take place through cheques. For these, cash may not be required at all. Each such transaction is simply recorded (as a deposit or withdrawal) in the written or electronic record of the account. Thus, the bank needs to keep very little money in the form of cash.

Why was there only Rs. 100,000 in the safe of the bank when Mohan Kumar went there?

Discuss: In case of a theft or robbery at a bank, it is the bank's responsibility to bear the loss. However, what would happen if all the people who had deposits in a bank felt insecure and decided to withdraw their money in cash all at the same time?

The banking system works on the assurance to the depositors that they can withdraw their money at any time, and that their money will not be lost. The following story illustrates how this principle might have begun in India.

How did Banking Begin?

Hundreds of years ago, people who wanted to borrow money (which was then usually in the form of gold or silver coins) would go to moneylenders, or shroffs. By lending, the shroffs could make a profit because they charged interest (i.e. the borrowers would have to pay back slightly more than what they had borrowed).

Some people started trusting the shroffs and giving them their gold for safekeeping. The shroffs gave them receipts that stated how much of their gold was lying with them. People found that this was a convenient system, and whenever they wanted they could get their gold from the shroff. They found that their gold was always safe and available on demand. The shroffs also gave the depositors some interest. The people's trust in the shroffs grew. So more and more people kept their gold with them.

The shroffs found that after some time they had accumulated lots of gold. This was because the amount of gold that people withdrew at any given time was relatively small. The shroffs found that they could easily lend some of this gold without risking a shortage. They would still be able to meet the demand of the depositors who wanted to withdraw their gold.

Suppose a trader had a receipt for a certain amount of his gold that was lying with a shroff. When he purchased goods from someone, rather than paying in gold, he might just give the receipt. The receipt would be accepted only if the shroff was trusted. Maybe this is how the system of paper bank notes began.



A shroff accepting a deposit from a customer (painted around 1760).

Why did people keep their gold with the shroffs?

How could the shroffs make use of these deposits, without getting into problems?

Would this system work if people had kept their special gold ornaments with the shroffs instead of bars or lumps of gold?

Loans

Many people save their money in bank accounts and in this way banks accumulate a lot of money. Banks then use this money to give loans. For some special lending schemes, the government also gives extra money to banks.

Some loans are given for trade and commerce. For example, loans may be given to someone who needs to buy machines, run a factory, set up a business, buy a truck or construct a building. Banks fulfil

the needs for such loans and take interest according to their rules. One such example is as follows:

Narmada Soyabean Company wanted to set up one more factory to extract oil from soyabeans. Its manager drew up a loan plan for Rs. 200 lakh (two crore) and submitted a proposal to the bank. The bank officials studied the loan plan and held discussions. They were convinced that the factory would be able to run successfully. The loan was sanctioned. The company had also invested Rs. 50 lakh from

its own money. For its security the bank **mortgaged** the machinery that was bought. This means that if for some reason the factory fails to run and the company does not get enough money to repay the loan, the bank can then sell the mortgaged machinery and recover the loan. An interest rate was fixed and a scheme was worked out as to how the loan would be repaid. It was decided that after the company's production of oil takes place, it will keep returning the loan in instalments.

Banks also give another kind of loan that is related to government schemes. The government wants agricultural production to be increased. Thus, banks give many kinds of loans for agriculture - for the purchase of fertilisers and seeds, for digging wells, buying an electric motor, purchasing cattle, tractors and threshers, for the improvement of agricultural land, etc.

For example, Dhanna Lal and Badri Prasad had each given applications for loans. Dhanna Lal had 8 acres of land. He needed money for fertilisers and seeds at the time of sowing. So he took a loan of Rs. 10,000. He mortgaged his harvest as security. After selling the harvest Dhanna Lal will return the loan to the bank, along with interest.

Badri Prasad had 20 acres of land. He applied for a loan for a tube well. He had Rs. 10,000 and wanted a loan of Rs.45,000 from the bank. In this case, he mortgaged his land as security with the bank. He will return the money, plus interest in instalments, within 5 years. If he does not return the loan, the bank can sell his land and recover its money.

Both the applications were accepted and

sanctioned. Thus, Badri Prasad was able to get his tube well dug and Dhanna Lal was able to sow his crop.

What types of loans do banks give?

Moneylenders also lend money. So what are the differences between moneylenders and banks?

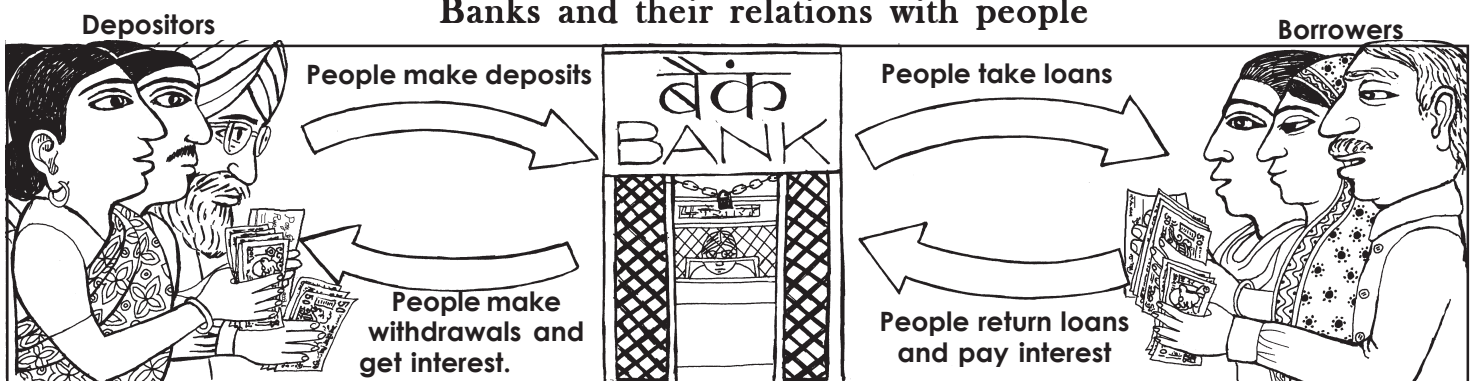
Find out an actual example of a loan given by a bank. Discuss the following:

- a) *The purpose and amount of the loan.*
- b) *The kind of security kept, if any.*
- c) *The manner in which the borrower has to repay the loan.*
- d) *How much the borrower will have to pay back in all.*

Functions of Banks

A bank has two major functions - to accept deposits into different types of accounts and to give loans to people who need them. This flow of money is shown in the diagram below. The borrowers return loans along with the interest. It is from this interest that the bank earns money needed for its work. The bank keeps the depositors' money safe and pays cash whenever the depositors want. It also pays interest on savings / fixed deposit accounts. Besides this, there is a special feature of banks. Money transactions can be done from bank deposits without actually exchanging cash. This exchange of money is mainly done through cheques.

Banks and their relations with people



Exercises

1. Fill in the following table with as many examples of money transactions as you can:

Transactions involving Rupee notes and coins	Transactions that don't involve Rupee notes and coins

2. Can there be any difficulties or disadvantages in keeping money in a bank? Think and write.
3. Suppose you need Rs. 2000. You draw a cheque, give it to your sister and send her to get the money in cash. Draw the cheque in your note book. (Make it for an imaginary sister if you like.)
4. In what ways have cheques made exchange of money more convenient?
5. How is a crossed cheque safer than an ordinary cheque?
6. Only a part of the total deposits is kept as cash in the bank-safe. Why is this so and how does this benefit the bank?
7. If a very large number of account-holders do not wish to keep their money in the bank, how will it affect the bank's working?
8. If a great many loans are written off (that is, borrowers are not required to pay back the money), how will this affect the working of the bank?
9. People have to pay a higher interest on a loan than the interest they receive on a fixed deposit for the same time-period. Why do you think this is so?
10. Read the example of loans for agriculture again and answer the questions given below:
- (a) If Dhanna Lal or Badri Prasad do not return the money they have borrowed, what can the bank do?
- (b) The time periods given to Dhanna Lal and Badri Prasad to return the money are different. Why?
- (c) Why does the government give loans like those given to Dhanna Lal and Badri Prasad?
- (d) Suppose this year the rains are poor and the crop yield is only half as much as was originally expected. Some people say that if this happens the farmers should be asked to pay back only half the amount they have taken as loans. However, other people say that the full amount should be repaid, keeping in view the next year's crop. In your opinion what should the bank do, and why?
12. Apart from cheques, people can also exchange money through Bank Drafts. Find out:
- (a) How do you send a Bank Draft?
- (b) For the person receiving the money what advantage does a Draft have compared to a cheque?
13. Suppose a moneylender charges 2.5% interest per month (which is 30%/year). Compare this with the rate charged by banks. So why do a large number of people go to moneylenders still?
14. Look at the table and answer the following questions:

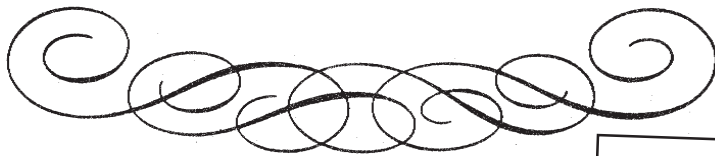
- (a) Calculate the percentage of each type of money and fill in the table.
- (b) What does this table show? In which form is most of the money kept and why?

Form of money	Amount	Percentage
Notes and coins	Rs. 209,000 Crores	
Bank deposits (Savings, Current and Fixed Deposits)	Rs. 1097,000 Crores	
Total	Rs. 1306,000 Crores	



CHAPTER 2

TAXES



Fertilizer prices up

expansion of the scheme for distribution of subsidised cereals through ration shops

Higher tax on petrol, diesel

48 new projects planned at a cost of Rs. 40,000 crores

Income tax deductions on housing loans to stay

Customs duty on gold reduced

Service tax extended to even categories

for one year on an experimental basis.

AC, soft drinks to cost less

For the consumers, motor cars, air-conditioners, soft drinks etc. will cost less since the excise duty on these products has been reduced from 32

only.

Pressure cookers, biscuits, boiled sweets and dental chairs will cost less because of lower excise duty while articles such as umbrellas, wood articles, adhesive tapes, imitation 'zari,' walking sticks, bicycle and parts, utensils and kitchen articles, knives, spoons and similar items, and glasses for corrective spectacles will cost much less because the duty on them has been abolished.

Public-private partnerships for infrastructure

an estimate of 60,000 crores is to be spent on new roads.

The finance minister has made it clear that if the defence ministry makes a case for larger funding it will be granted

Excise on soft drinks, cars, air-conditioners

Life saving drugs to cost less

Excise duty on cements up

Take a look at the above newspaper clippings about the budget. One mentions that fertiliser will cost more. Another says that air conditioners and soft drinks will cost less. All this big news was about the budget that the government had announced for the upcoming year.

One part of the budget shows the revenue – what the government will earn and where it will get money from. The other part of the budget gives information about the **expenditure** - where the government will be spending money - for example, how much on defence, how much on projects, how much on running the government, etc.

The Union Finance Minister presents the Central Government's budget in the Parliament. It is then discussed, debated and modified. Once it has been approved, the budget is implemented.

Similarly, in the states too, the finance minister of each state presents the budget in the Vidhan Sabha. States get money from taxes they levy and they also get a share of the taxes collected by the central government. In this chapter we shall

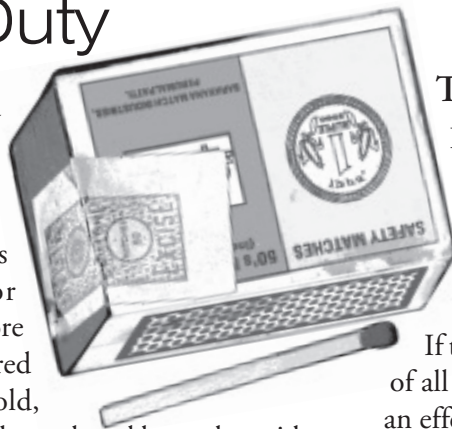
discuss some of the important taxes levied by the Central and State Governments.

Discuss with your teacher: Why does a government need a budget?

Look at the news items in the illustration on the previous page. Identify the ones which deal with the government's expenditure and the ones which deal with the government's revenue.

Excise Duty

See if you can find a matchbox with a label that says 'Central Excise'. Excise duty is the tax charged on goods that are produced or made in factories. Before the goods manufactured in a factory can be sold, excise duty on the goods produced has to be paid. The owner or manager of the factory pays the money for this tax to the government according to the quantity of production. However, this tax is not imposed on all things that are produced.



Excise duty is paid to the government by the factory itself, but in reality the burden of the tax falls on those who buy the goods. The factory owners increase the prices of the goods they sell in order to cover the amount they pay in tax.

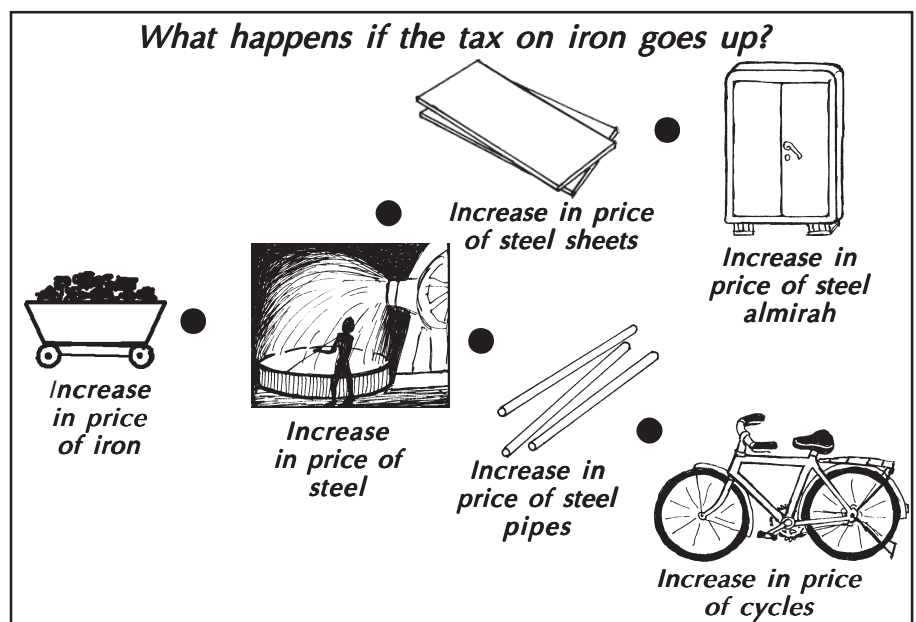
For example, suppose the cost of manufacturing a TV set is Rs. 4,000. The company wants to make a profit of Rs. 1,000 on each set. It also has to pay an excise duty of Rs. 800 to the government. So it will then sell each TV set for Rs. 5,800 to the dealer.

The Effect of Excise Duty

In order to produce one item, often a large number of other things are used. For example, to manufacture bicycles, steel pipes are needed. In order to make steel, the steel factory needs iron and coal.

If the excise duty on iron is increased, the prices of all goods made of iron will go up. It will have an effect on cycles as well.

For instance, iron is used to make steel, so the prices of all things made of steel will also go up. In this way, a tax increase on iron has far reaching effects.



As shown here, the people who buy cycles and almirahs bear part of the increase in tax on iron.

Look carefully at the illustration on the next page. It shows how many things are made from crude oil - petrol, diesel, kerosene, plastic, synthetic cloth (e.g. terricot and nylon), fertiliser, furnace oil etc. If the tax on crude oil is increased, the prices of all these things would go up.

Petrol and diesel are used to run vehicles. For example, trucks, trains, tractors, buses and jeeps run on diesel. Petrol is used for scooters, motorcars etc. What will happen if the price of diesel goes up? Naturally, it will be more expensive to run trucks, jeeps and such vehicles. But it will also become more expensive to transport goods, so the prices of goods will go up.

Whenever excise duty is increased on any material, it affects the prices of all those things for which the material is used. It sets up a chain reaction and all things which are connected to this thing are affected, in one way or the other.

Sales Tax

This is charged when goods are first sold. The manufacturer or shopkeeper pays this tax and the amount is added to the price of the goods. The consumer therefore has to bear this tax. Suppose we buy a packet of biscuits which says; “Rs. 10 MRP. (All taxes inclusive)”. MRP stands for Maximum Retail Price i.e. the maximum price that can be charged to the consumer. This price includes excise duty, sales tax and other taxes. For example, in the above packet of biscuits Rs. 2 was paid as tax.

This system of showing the MRP on products was not very widespread until recently. Fifteen or twenty years ago, shopkeepers used to charge an extra amount over and above the printed price in order to cover the sales tax. The wrappers would show the price with the note saying “local taxes extra” (L.T.E.). You can still see this on some medicine wrappers.

If the tax on iron is increased, give some examples of other things not mentioned here that this will affect.

Make a chart like the one on the previous page to show what might happen if the tax on crude oil increases.

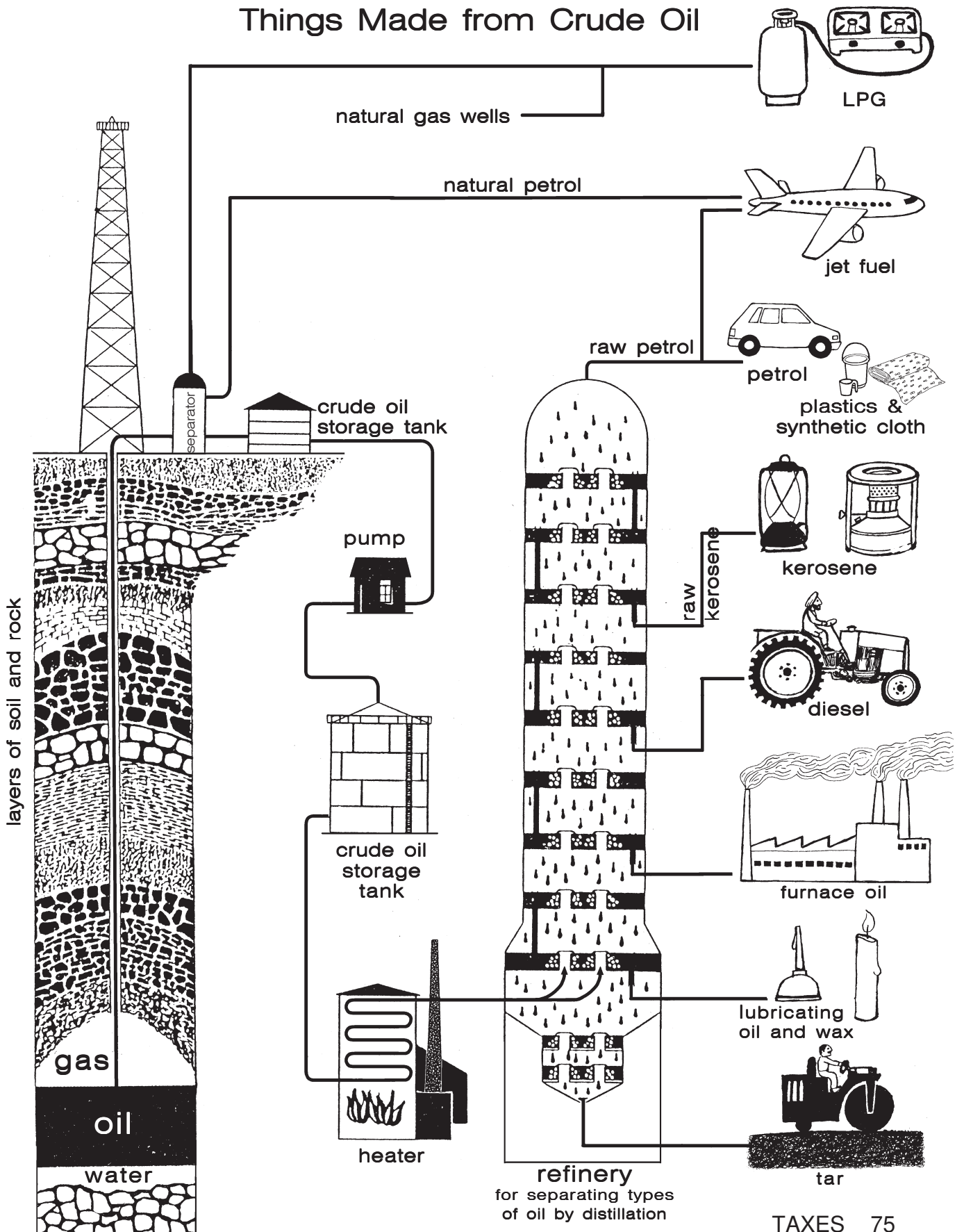
What do you think is the advantage of showing the MRP on goods?

What is the difference between sales tax and excise duty?

Find the maximum retail prices printed on five different packets.



Simplified Schematic Diagram Things Made from Crude Oil



Value Added Tax

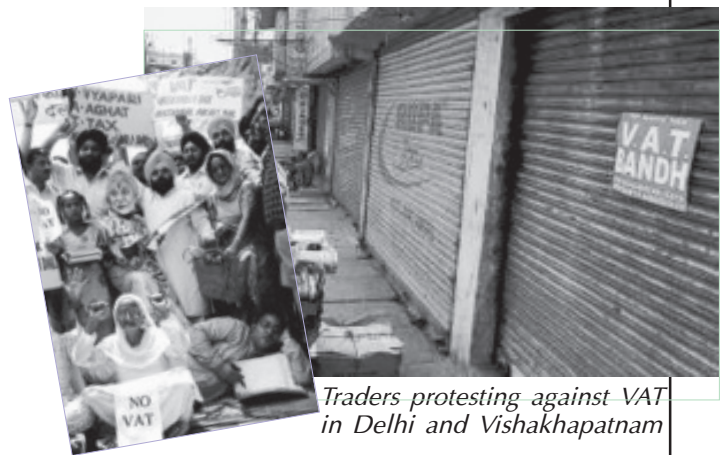
In the last couple of years, Value added tax has been in the news because all the state governments are shifting to this system. There will only be a few rates and these will be same all over the country. This appears to be advantageous and yet there are protests and campaigns against this by traders. Let us look at some of these aspects.

Value added tax is a different way by which a tax is calculated for goods. This is done for both excise and sales tax but we will take an example of sales tax, which is now being discussed, in the country.

What is value added? One way to calculate sales tax is to base this on the sale price of the good. For example a manufacturer marks Rs. 10 MRP on the packet of biscuits and pays a sales tax of 10% i.e. Re .1 on each packet of biscuits sold. The other way would be to charge sales tax not on the sale price but on 'value added'. i.e. the value that has been added by the manufacturer after purchasing the inputs that is required to make biscuits. Let us assume that the manufacture spends Rs. 3 on the purchase of inputs such as wheat flour, sugar, oil etc. which includes Rs. 0.3(30 paisa) as tax already paid. Hence the manufacturer will now have to pay Re. 1 less 0.3 i.e Rs. 0.7 as the value added tax. Therefore tax has been paid on the value added after purchasing inputs and not on the total value as in the earlier system.

Why is value added system preferred? Goods go through a chain of people in the process of manufacturing and selling, before they reach the final consumer. If a sale tax is charged every time a sale takes place then the actual tax on the final product is very high. For example, if we add up all the sales taxes paid for this packet of biscuit it would mean adding not only the tax paid by the manufacturer but also the taxes paid by the flour mill, the sugar mill and the oil factory - all those who have supplied the inputs for the biscuits. In the value added system inputs are not taxed again. Hence in this system the total tax on the good should be less and therefore it should cost less.

This system is also preferred because of the decision to have the same rates for the entire country and states do not lure customers by offering lower rates or concessions. In the earlier system people would travel to far off places to purchase consumer goods because of sales tax concessions, medicines would be smuggled across state borders because it is cheaper in one state, companies would show sales from places where the tax is lower etc.



Traders protesting against VAT in Delhi and Vishakhapatnam

If this system is preferred, then why were traders protesting? There are many reasons for this – some genuine and some not so genuine. The state governments haven't sufficiently worked out and publicised the details of how this system will be implemented and hence there is lot of confusion. In many cases the new rates are more. So the cost of some goods will be more rather than less. Traders are also annoyed because in the new system they will have to keep genuine record of their sale and purchase. It is on this basis they can show the tax already paid on cost of inputs. The tax department will be able to match records of the seller and purchaser. Evasion of sales tax, which is very common, will be more difficult.

Talk to some shopkeepers and traders and find out their views about this?

What is your opinion about the new system?

The Tax System

Most items reach the consumer from the manufacturer through a chain of buying and selling by 'middle-men' (wholesale dealers and retailers).



There are various taxes, such as excise duty and sales tax, which are paid and then included in the price of the goods. At every stage there are some costs and some profits made by the sellers. For example, here is a breakdown of all the charges (in rupees) for the TV set mentioned earlier.

Cost of manufacture, transport, storage ...	5,000
Profit of the manufacturer	1,000
Profit of the wholesale dealer	400
Profit of the retail trader	600
All taxes paid (excise duty + sales tax)	2,000
Cost to the consumer (MRP)	9,000

This is only an example. The percentage earned as profits and the taxes paid would vary from item to item. For some items, such as computers, medicines etc the profit margins are much higher.

What percentage of the cost of the TV set did the consumer pay as tax?

Collect the labelled wrappers or boxes of some items and note the MRP. Discuss in class the probable taxes paid.

If there are two people manufacturing the same kind of thing and one of them evades paying taxes, what advantages could he have over the other?

Sales tax charged by the state government is a major source of revenue for the state. Different states earlier had different tax rates. The state governments have now moved to a different way of charging this tax. This is now called Value Added Tax (VAT) about which you have already read.

Customs Duty

Apart from sales tax and excise duty, another kind of tax is levied on certain things. This is known as customs duty. It is charged on those things which we bring from other countries. For example, a person returning from a foreign trip brings a computer with her. At the airport in our country she will have to pay a customs duty. Many factories need machines or raw material to be brought from foreign countries. Customs duty has to be paid on these things too.

Among the news items in the beginning of the chapter, can you locate one which deals with customs duty? In what ways would this decision affect the traders and consumers of this commodity?

Why can't the government charge excise duty on those goods for which it charges customs duty?

Income Tax

Besides taxes on goods such as excise, custom and sales tax, there is also **income tax**. Income tax is levied on the income of individuals or on the profits earned by companies and businesses.

As we have seen, the prices that we pay when we buy some things in the market include whatever taxes have been levied on them. Hence, in effect, we pay these taxes when we **spend money**. Tax may also be charged when we **earn money**, i.e. we may pay tax on our income.

Tax should be collected fairly.
Let's read about some possible ways of doing this.

What is a fair way of collecting income tax?



- 1. Fixed Amount:** You may think it is fair for everyone to pay the same amount of tax. Would it really be fair if each of the following three people has to pay the same amount?

Person	Work	Earning (per month)	Tax as fixed amount (per month)
Jyoti	Daily wage labourer	1000	50
Asif	School teacher	6000	50
Jatinder	Business person	20,000	50

If Jyoti cannot even afford to feed her children properly, is it fair for her to pay Rs 50 as tax?

- 2. Fixed Proportion:** You may think it is more fair to ask each person to pay a certain percentage of what he or she earns. Supposing everyone paid 10% in taxes. Calculate how much each of the following persons would pay.

Person	Earning (per month)	Tax as a fixed proportion (per month)
Jyoti	1000	
Asif	6000	
Jatinder	20,000	

Would this be fair? Jyoti may still not have enough money to live on. Asif may not have enough to repair his house. But Jatinder may have plenty of money for all the basic necessities even after paying 10% in taxes.

- 3. Variable proportion:** To make taxes more fair you may then say that only people earning more than a certain amount, say Rs. 4000 per month, have to pay taxes. You may also say that the richest people should pay a greater proportion of their earnings.

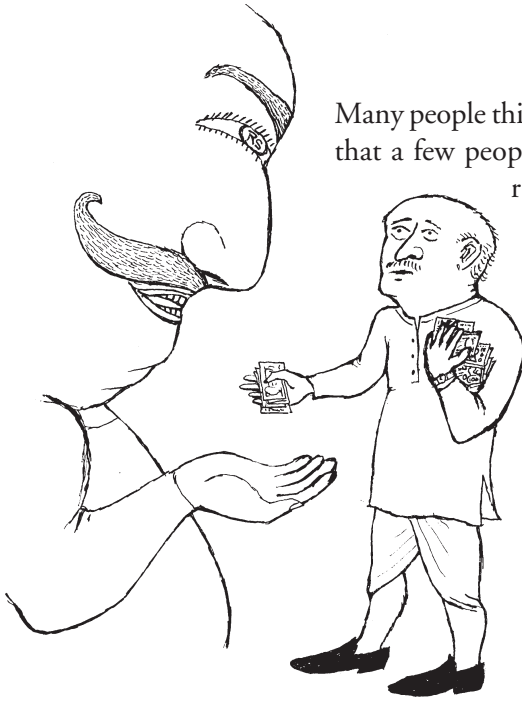
For example:

If you earn	You will pay as tax
Less than 4000	0%
4000 to 5000	10%
5000 to 15000	20%
More than 15000	30%

Use the above Table to calculate how much each person would then pay.

Person	Earning (per month)	Tax as a variable proportion (per month)
Jyoti	1000	
Asif	6000	
Jatinder	20,000	

Would this be fair?

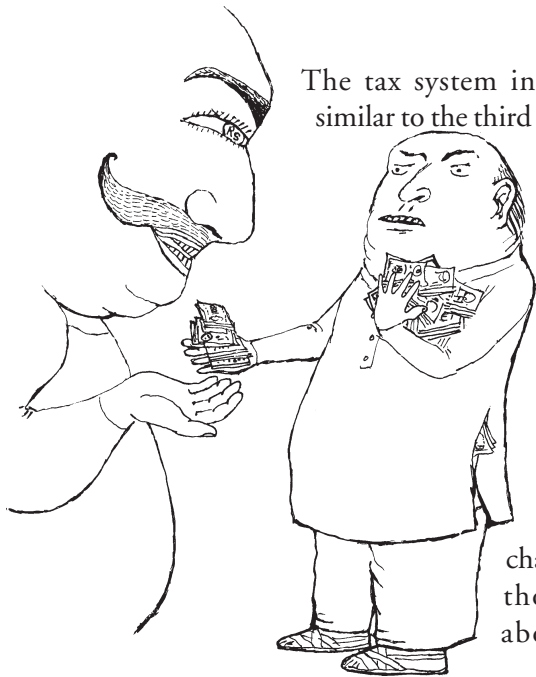


Many people think it is not right that a few people earn lakhs of rupees while others don't have enough to eat. They feel that the government should collect more taxes from the rich than from the poor. Besides, there is also a need to improve the income of the

poor by providing better job opportunities and living conditions.

Suppose Kanti has an income of Rs. 100,000 per year and pays an income tax of Rs. 3000, and Kamlesh has an income of Rs.200,000/year and pays Rs.26,000.

- a) Who pays more income tax?
- b) Who has to pay a larger part of the income as tax - the one who earns more or the one who earns less?



The tax system in India today is similar to the third example on the previous page: the amount of income tax that each person is supposed to pay is **proportional** to how much they earn. Income tax is charged only from those who earn above a certain

amount. Those who earn a higher income have to pay a greater proportion of their income as tax. According to these rules a person who earns Rs. 1,50,000 per year pays 9% and another who earns Rs. 3,00,000 pays 19% of their income as tax. However, because there are also rules that allow for a large number of deductions, most people pay only a small portion of their income as tax. Even those who have high incomes hardly ever pay more than 6% of their income as tax.

According to the income tax rules those with higher incomes have to pay _____ (greater/smaller/equal) part as tax.

Corporate Tax

Apart from personal income taxes, companies that run factories or businesses also have to pay taxes. Companies or businesses receive money from the sale of their products or services. After subtracting all expenses (on raw materials, salaries etc.) from their earnings, the portion that remains is known as the profit of that company or factory. On this profit, corporate tax has to be paid according to rules.

Collection and Evasion of Taxes

We read about some of the major taxes collected by the government. Through which kind of tax is the government able to collect more money? Let's see . . .

The government gets revenue from many different kinds of taxes. It has to decide how much money to collect through each kind of tax. For this it has to consider: how many people would have to pay; whether this tax can be collected easily and how it would affect the rich and the poor. A related question is whether people will pay their taxes or evade paying taxes.

You know that a large number of people in our country depend on agriculture. Most of them are small and medium farmers. There are also some big farmers earning high incomes. However, all agriculture income is exempted from tax. Similarly, a large section of people in the country earn very low incomes from trade, running small shops, or providing labour. The income of these people is below the limit for income tax. On the other hand there are a number of people who should be paying tax but evade it. Thus the percentage of people in the entire country who pay income tax is very small (less than 2%).

However, since the total population is more than 100 crore, even this small percentage of people is sizeable. For example, in 1997 the incomes of 114 lakh individuals were assessed for income tax. They were living in different places in the country. Thus, collecting income tax is not easy.

Many people do not disclose their entire income or they show it to be less than what it actually is. This income, which is kept hidden, is known as **black money**.

Many factory owners, rich moneylenders, traders, and those doing private business can easily evade the law and show a low income. Because there is no tax on income from agriculture many wrongly show their income as income from land and therefore evade paying tax. It is easy to calculate the income of those who are paid monthly salaries. Tax on their income is directly deducted at the source from where they get their salaries. But many salaried persons also have other sources of income which they keep hidden.

Thus there are many 'tax evaders' and the black money on which tax should have been paid but wasn't, goes on accumulating. To get hold of this hoard of black money, the income tax department raids many people's places. It has also tried to make the procedures for paying tax more convenient. Despite these efforts a large number of people do not pay any income tax. Hence the government is unable to collect a very large sum of money from this tax.

What are the reasons why income tax is not able to yield much money to the government?

On the other hand taxes on goods can be collected more easily since there are fewer places from where they have to be collected. Excise duty is collected from factories, customs duty from international airports and seaports and sales tax from traders and shopkeepers. As compared with income tax to be paid by individuals the government finds it easier to keep a track of these factory records or shops.

Even here, there are those who try to escape taxes by showing lower production than has actually taken place. Sales tax is evaded on a wide scale. Some people, by not issuing proper bills or recording it in their official registers show much lower sales than actually occurred.

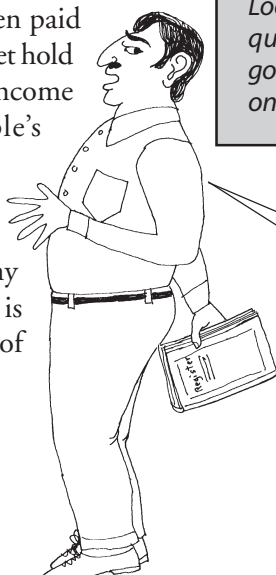
Taxes collected by the government

<u>Taxes on goods</u>	<u>Percentage of total tax</u>
Excise duty	26%
Sales tax	23%
Customs duty	18%
Other taxes on goods	14%
Total tax on goods	81%

<u>Taxes on income</u>	<u>Percentage of total tax</u>
Income tax	9%
Corporate tax	9%
Other taxes on income	1%
Total tax on income	19%

Total taxes on goods and income 100%

Look at the above table and answer the following questions: From which type of tax does the government earn more -- taxes on income or taxes on commodities? What is the reason for this?



QUICK! HIDE THIS REGISTER! SHOW THE OTHER ACCOUNT REGISTERS TO THE TAX PEOPLE...

One problem that is often encountered and that has serious consequences is evasion of taxes. For example, in a certain town a large number of residents do not pay the required property tax. Discuss how this might affect the life of the people in that town.

In the history chapters you have seen that agriculture has usually been taxed. However, in this chapter you read that agricultural income is not taxed at all. Why do you think this is so?

other things. You can guess how many industries, factories and businesses use these things. People do not buy them directly. To get more income, the government levies high taxes on those things which are very widely sold but which are not directly used by people.

One year the government heavily taxed luxury items such as refrigerators and air conditioners. This yielded Rs. 183 crores. In the same year the government got Rs. 2941 crores from a tax on crude oil. Compare and explain the difference in income.

The Effect of Taxes on Goods

While imposing a tax, the government keeps in mind whether it is more likely to affect the rich or the poor. While levying taxes on goods, however, it becomes a little more difficult to distinguish between the poor and the rich. Whether rich or poor, everyone has to pay the same amount of tax when buying something.

However, there is a way by which a distinction can be made between some goods. For example, grains, vegetables, cloth, kerosene, cooking oil - all these things are essential and, rich or poor, everyone buys them. However, the poor spend most of their income on these things. There are other things which only the rich can purchase: refrigerators, cars, motorcycles, air-conditioners.... It is difficult for the poor to afford these 'luxuries'. Hence one way to distinguish between rich and poor is not to tax essential things but to tax luxury items.

The problem is that since not many people can afford to buy these luxury items, taxing **only** such things cannot bring much income to the government.

On the other hand there are also many things which are not directly used by people, such as diesel, steel, aluminium, machines, trucks, truck tyres etc. Such things are used to make or transport

Can we say that imposing taxes on things such as crude oil, iron, steel etc does not have any effect on the poor? We saw that when the tax is increased on such things, the increase gets added to the cost of those things which are made from them or transported with their help. Thus, even the poor who buy grain or cloth have to pay some part of the tax on diesel or steel. When the tax on such things is increased, the price of many other things goes up. To take an example of this, read a news item that appeared a week after the annual budget.

"The increase in the price of petrol and diesel alone has led to an all-round increase in prices. Fruits, vegetables, dals and other food items, for example, have become more expensive."

I'M SURE WE'LL END UP PAYING...
THE THINGS WE NEED TO BUY
WILL COST MORE!



Who will be affected more if the tax on kerosene is increased? And who will be affected more if the tax on computers is increased?

Which tax increase will yield more money -- a tax on crude oil or on cars? Why?

Which tax increase will affect the prices of other goods more -- on crude oil or on kerosene? Why?

We saw that the government earns a greater income through taxes on goods. Among goods, too, it receives more tax from those things which

are used in the manufacture or transport of other goods. When the tax is increased on such things it has an all-round effect on prices.

For this reason the question that troubles everyone each year is: which taxes are going to be increased? We saw that much more money can be collected by a tax on goods, but this also affects the poor more. The burden of income tax falls more heavily on the rich, but the government is able to collect very little money through it. That is why the announcement of the budget is so important for everyone.

Exercises

1. Taxes charged and collected have always had a strong impact on people's lives. You have seen some examples. Can you recall some of them from the following:
 - a) What is mandi tax? What is it used for?
 - b) In the chapter on municipalities, why were people reluctant to pay the water tax?
2. Why does the government need a budget? Why does the budget talk of taxes?
3. Match the following:

Excise duty	levied on the yearly income of individuals
Sales tax	levied when goods are sold
Customs duty	levied on the production or manufacture of goods
Income tax	levied on the yearly profit of companies and businesses
Corporate tax	levied on goods brought from abroad
4. In the history chapter 'Villages in the Mughal Period' you will read about a system of land taxes.
 - a) What portion of their produce did the farmers have to pay as tax? What problems did they face?
 - b) How were the rules of land tax during that period different from today's income tax rules?
5. Steel, matches, clocks, cloth, iron - a tax increase on which of these would affect the prices of other commodities the most, and why?
6. Ordinary food item, such as grain, dals and oil are used by all. Then why is it said that imposing a tax on them will have a greater effect on the poor?
7. A group of four friends decided to stay together by contributing money towards the rent of a house. The rent was Rs 2000 per month.
 - a) How could this be shared among them?
 - b) We also know that two of them earned Rs 3000 per month and the other two Rs 7000 per month. Is there some way of sharing the cost so that each one feels the pinch equally?
 - c) Which way of sharing would you prefer and why?
8. Tax on income or tax on commodities - which of the two affects the rich more and which affects the poor more? Explain with reasons.