Introduction to Tax Structure in India

In a Welfare State, the Government takes primary responsibility for the welfare of its citizens, as in matters of health care, education, employment, infrastructure, social security and other development needs. To facilitate these, Government needs revenue. The taxation is the primary source of revenue to the Government for incurring such public welfare expenditure. In other words, Government is taking taxes from public through its one hand and through another hand; it incurs welfare expenditure for public at large. However, no one enjoys handing over his hard-earned money to the government to pay taxes. Thus, taxes are compulsory or enforced contribution to the Government revenue by public. Government may levy taxes on income, business profits or wealth or add it to the cost of some goods, services, and transactions.

**There are two types of taxes in India: Direct Tax and Indirect Tax**

Tax, of which incidence and impact fall on the same person, is known as Direct Tax, such as Income Tax. On the other hand, tax, of which incidence and impact fall on two different persons, is known as Indirect Tax, such as GST, etc. It means, in the case of Direct Tax, tax is recovered directly from the assessee, who ultimately bears such taxes, whereas in the case of Indirect Tax, tax is recovered from the assessee, who passes such burden to another person & is ultimately borne by consumers of such goods or services.

**Direct Tax**

● Incidence and impact fall on the same person

● Assessee, himself bears such taxes. Thus, it pinches the taxpayer.

● Levied on income

● E.g. Income Tax

● Progressive in nature i.e., higher tax are levied on person earning higher income and vice versa.

**Indirect Tax**

● Incidence and impact fall on two different persons

● Tax is recovered from the assessee, who passes such burden to another person. Thus, it does not pinch the taxpayer.

● Levied on goods and services. Thus, this type of tax leads to inflation and have wider base.

● E.g. GST, Customs Duty, etc.

● Regressive in nature i.e., all persons will bear equal wrath of tax on goods or service consumed by them irrespective of their ability.

● Useful tool to promote social welfare by checking the consumption of harmful goods or sin goods through higher rate of tax..

**CONSTITUTIONAL VALIDITY OF TAXES**

The Constitution of India is the supreme law of India. It consists of a Preamble, 22 parts containing 444 articles and 12 schedules. Any tax law, which is not in conformity with the Constitution, is called ultra vires the Constitution and held as illegal and void. Some of the provisions of the Constitution are given below:

Article 265 of the Constitution lays down that no tax shall be levied or collected except by the authority of law. It means tax proposed to be levied must be within the legislative competence of the legislature imposing the tax1.

Article 246 read with Schedule VII divides subject matter of law made by legislature into three categories

● Union list (only Central Government has power of legislation on subject matters covered in the list)

● State list (only State Government has power of legislation on subject matters covered in the list)

● Concurrent list (both Central &State Government can pass legislation on subject matters).

If a state law relating to an entry in List III is repugnant to a Union law relating to that entry, the Union law will prevail, and the state law shall, to the extent of such repugnancy, be void. (Article 254).

**The administrative hierarchy of tax law is as follows:**

**Ministry of Finance**

↓

**Department of Revenue**

↓

**Central Board of Direct Tax (CBDT) /Central Board of** Indirect Taxes **&** Customs **(CB**I**C)**

**Tax Point:**

* Both of the Boards have been constituted under the Central Board of Revenue Act, 1963.
* CBDT deals with levy and collection of all direct tax whereas matters relating to levy and collection of Central indirect tax are dealt by CBIC.

**Outline of Income Tax Act 1961**

In India, this tax was introduced for the first time in 1860, by Sir James Wilson in order to meet the losses sustained by the Government on account of Military Mutiny of 1857. Thereafter, several amendments were made in it from time to time. At last, in 1886, a separate Income Tax Act was passed. This Act remained in force up to 1917, with various amendments from time to time. In 1918, a new Income Tax Act was passed and again it was replaced by another new Act which was passed in 1922. This Act, remained in force up to the assessment year 1961-62 with numerous amendments.

The Income Tax Act of 1922 had become very complicated on account of innumerable amendments. The Govt of India, therefore, referred it to the law commission in 1956 with a view to simplify and prevent the evasion of income tax. The law commission submitted its report in September 1958, but in the meantime the Government of India had appointed the Direct Taxes Enquiry committee to suggest measures to minimise inconveniences to assess and to prevent evasion of tax. This committee submitted its report in 1959. In consultation with the Ministry of Law finally the Income Tax Act 1961 was passed.

The Income Tax Act, 1961 has been brought into force with effect from 1st April 1962. It applies to the whole of India. Since 1962 several amendments of far reaching nature have been made in the Income Tax Act by the Union Budget every year, which also contains Finance bill. After it is passed by the House of Parliament, and receives the assent of the president of India, it becomes the Finance Act. Besides this, amendments have also been made by various amendment Acts, for instance, Taxation Law Amendment Act 1984, Direct Tax Law Act 1989, The Taxation Law Act 1991….

**Components of Income Tax Law**

The present Income tax law includes,

* The Income Tax Act 1961 (amended up to date)
* The Finance Act passed every year.
* The income Tax rules 1962 (It is framed and amended by Central Board of Direct Taxes from time to time.
* Judgments of the court of law.
* Circulars, orders, notifications and executive instructions issued by Income tax department from time to time.

**CBDT** is the apex body of the Income Tax Department. It is the supreme authority and administrative head of the income tax department. It functions as a part of the Finance Ministry of the Government of India. CBDT is empowered to frame rules subject to the control of the Central Government for the administration of the income tax.

**Basic concepts and definitions**

**Assessee ;Sec 2 (7)**

Assessee is a person who has liability to pay any tax or any other sum of money under this Act, and includes;

1. Every person who has liability to pay any tax or any other sum of money under this Act has been taken for the assessment of his income or the assessment of fringe benefits or of the income of any other person in respect of which he is assessable, or of the loss sustained by him or by such other person, or the amount of refund due to him or to such other person,
2. Every person who is deemed to be an assessee under any provisions of this Act.
3. Every person who is deemed to be an assessee in default under any provisions of this Act.

**Deemed Assessee ( Representative Assessee)**

The person who is deemed to be an assessee includes legal representative, agent of a non resident, guardian or manager of an infant and lunatics and trustees and administrators. In other words a person who is liable to pay tax, not on his own income but on the income accrued to others is also treated as assessee. For example, guardian of a minor is deemed to be an assessee or representative assessee.

**Assessee in default**

A person is deemed to be an assessee if he fails to fulfill his statutory obligations. When a person who is liable to deduct tax at the source, but does not do so or after deducting the tax does not pay it to the government or who fails to pay installments of advance income tax in time, he will be called an assessee in default. For example, an employer deducts the tax from his employees’ salary, but does not remit it to the treasury, he is an assessee in default.

**Assessment Sec.2(8)**

Assessment is the process of computation of total income of an assessee in the previous year and the determination of the tax liability.

**Assessment year Sec.2(9)**

It means the period of twelve months commencing on the 1st day of April every year and coming to an end on 31st March. It is during this period that assessment takes place. In other words , the financial year in which the income of the previous year is assessed is called assessment year. The current assessment year is 2016-17. It is also known as the financial year, fiscal year or the accounting year of the central Government.

**Previous year Sec.3**

Income tax is charged on the total income of the previous year at rates of income tax which are prevalent in the assessment year.

* Previous year means the financial year immediately preceding the assessment year.
* Previous year is the financial year or a period of 12 months immediately preceding the assessment year.
* In the case of a business or profession newly set up or a source of income newly coming into existence, the previous year shall be period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly comes into existence and ends on the 31st March of that financial year.

**Exceptions to the general rule of PY**

* **Income from non-residents from shipping business (172):** If a non resident, uses a ship owned or chartered by him for the carriage of the passengers, livestock, mail or goods shipped at the port of India, his income from the business will be taxed in the same year in which he has earned income.
* **Income of persons leaving India (174):** If it appears to the income tax officer that an individual may leave India during the current assessment year or soon after its expiry, without any present intention of returning India, He may assess him for the income of the relevant previous year, including the income up to the probable date of departure from India, in the current assessment year itself.
* **Income of persons likely to transfer assets to avoid tax (175):** If it appears to the assessing officer that any person is likely to transfer or dispose of his asset with the object of avoiding tax liability, he may assess such person for his total income from the close of the relevant previous year up to the date on which proceedings are launched by the assessment officer, will be assessed to tax in the same year.
* **Income of a discontinued business, profession or vocation (176):** The income of a discontinued business, profession or vocation from the expiry of the last previous year up to the date of discontinuance, may be charged to tax in the same year at the discretion of the assessment officer

**Person Sec.2(31)**

Person includes;

1. An individual,
2. A Hindu Undivided Family
3. A company,
4. A firm,
5. An association of persons or a body of individuals, whether incorporated or not,
6. A local authority, and,
7. Every artificial juridical person, not falling within any of the preceding sub clauses.

**Income Sec.2(24)**

Income tax is charged on total income of an assessee. Income include;

* Profits and gains,
* Dividend,
* Voluntary contributions received by a trust created wholly or partly for charitable or religious purposes or by an institution established wholly or partly for such purposes.
* The value of any perquisite or profit in lieu of salary taxable under salary.
* Any special allowance or benefit, other than perquisite specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment.
* Any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.
* The value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment would have been payable by the director or other person aforesaid.
* The value of any benefit or perquisite, whether convertible into money or not, obtained by any representative assessee or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee and any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary.
* Any sum chargeable to income tax as profits and gains of business or profession.
* Any capital gain chargeable under section 45.
* The profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society, computed in accordance with Section 44, or any surplus taken to be such profits and gains by virtue or provisions contained in the first schedule.
* The profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members.
* Any winnings from lotteries, cross word puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.
* Profits and gains of business of banking carried by a co-operative society with its members.
* Voluntary contribution received by non-profit seeking university or other educational institution or by any non-profit hospital or other institution shall also be deemed to be income of such institutions.

**Gross Total Income**

GTI means the total income computed in accordance with the provisions of this Act, before making any deduction under Sec. 80C to 80U. In other words it is the aggregate taxable income under the different heads of income such as,

* income from salary,
* Income from house property,
* Income from profits or gains of business or profession,
* Capital Gains, and
* Income from other sources.

**Total income Sec 2(45)**

Total income means the total amount of income referred to in Section 5, which is computed in the manner laid down in this Act. It is computed on the basis of residential status of the assessee.

**Type of Companies**

* Indian Companies

'Indian Company' means a company formed and registered under the Companies Act, 1956 and includes—

1. a company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu and Kashmir and the Union Territories;
   1. a corporation established by or under a Central, State or Provincial Act;
   2. any institution, association or body which is declared by the Board to be a company;
2. in the case of the state of Jammu and Kashmir, a company formed and registered under any law for the time being in force in that State;
3. in the case of any of the Union territories of Dadra and Nagar Haveli, Goa, Daman and Diu, and Pondicherry, a company formed and registered under any law for the time being in force in that Union Territory.

Provided that the registered or, as the case may be, principal office of the company, corporation, institution, association or body, in all cases is in India.

Domestic Companies: - A domestic company means an Indian company or any other company which in respect of its income, liable to tax under the Income-tax Act, has made the prescribed arrangements for the declaration and payment within India, of the dividends (including dividends on preference shares) payable out of such income. Thus, all Indian Company are treated as Domestic Company but all Domestic Company are not Indian Company. If a Foreign Company makes prescribed arrangements for payment of dividends in India it shall be treated as Domestic Company.

Foreign Companies :- Foreign company means a company which is not a domestic company, i.e. a company registered outside India in any other foreign country.

The Foreign Company may be treated as Domestic Company if such company makes prescribed arrangement in India as per Rule 27. The arrangements shall be as follows :

1. The share-register of the company for all shareholders shall be regularly maintained at its principal place of business within India, in respect of any assessment year from a date not later than the 1st day of April of such year.
2. The general meeting for passing the accounts of the previous years relevant to the assessment year and for declaring any dividends in respect thereof shall be held only at a place within India.
3. The Dividend declared , if any, shall be payable only within India to all shareholder

Widely Held Companies:- t is a company in which the public are substantially interested. Section 2(18) of the Income-tax Act, has defined "a company in which the public are substantially interested". It includes:

1. **A company owned by Government or Reserve Bank of India.**
2. **A company having Govt. participation**i.e. A company in which not less than 40% of the shares are held by Government or the RBI or a corporation owned by the RBI.
3. **Companies registered under section 25 of the Indian Companies Act, 1956:** Companies registered under section 25 of the Companies Act, 1956 are companies which are promoted with special object such as to promote commerce, art, science, charity or religion or any other useful object and these companies do not have profit motive. However, if at any time these companies declare dividend they would loose the status of a company in which the public are substantially interested.
4. **A company declared by the CBDT:** It is a company without share capital and which having regard to its object, nature and composition of its membership or other relevant consideration is declared by the Board to be a company in which public are substantially interested.
5. **Mutual benefit finance company,** where principal business of the company is acceptance of deposits from its members and which has been declared by the Central Government to be a Nidhi or a Mutual Benefit Society.
6. **A company having co-operative society participation:**It is a company in which at least 50% or more equity shares have been held by one or more co-operative societies.
7. **A public limited company:** A company is deemed to be a public limited company if it is not a private company as defined by the Companies Act, 1956 and is fulfilling either of the following two conditions:
   1. Its equity shares were listed on a recognised stock exchange, as on the last day of the relevant previous year; or
   2. Its equity shares carrying at least 50% of the voting power (in the case of an industrial company the limit is 40%) were beneficially held throughout the relevant previous year by Government, a statutory corporation, a company in which the public is substantially interested or a wholly owned subsidiary of such a company.

* Closely Held Companies:- A company in which the public are not substantially interested is known as closely held company. The majority of shares are held by a small group of shareholders and these shares are publicly traded on occasion but not on a regular basis.

**Residential Status**

Section 5 of the Income Tax Act lays down the provisions relating which income of the previous year are to be included in the total income of an assessee for the purpose of charging tax.

**Resident Company:** An Indian company is always a resident in India.  
A non-Indian company is said to be a resident in India, if its place of effective management, in that year, is in India.

“Place of effective management” means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole, are in substance made.’

**Non-Resident Company:** If place of effective management, in that year, is not in India, the said company is non- resident in India for the relevant previous year.

Taxpoint: In case of company, there is no sub-division like ‘Ordinarily resident’ or ‘Not ordinarily resident’.

**MAT**

MAT stands for “Minimum Alternative Tax” that has been introduced to collect tax from the companies that have been enjoying tax benefits or tax exemptions in spite of having huge profits. These companies distribute considerable dividends to shareholders but take advantage of various provisions of income tax law such as exemptions; deductions etc. to avoid paying tax. Such companies are basically zero tax or minimum tax paying companies. Given an increase in the number of such low tax paying companies, MAT was introduced by the Finance Act, 1987 with effect from next financial year, i.e. 1988-89. Later on, it was withdrawn by the Finance Act, 1990 and then reintroduced by the Finance (No.2) Act, 1996, w.e.f, 1-4-1997.

**Provision of MAT as per Section 115JB**

There are specific provisions under the [Income Tax Act 1961](https://tax2win.in/guide/components-of-income-tax-law), under which the MAT is collected from every company. It is calculated under section 115JB of the Income Tax Act.

* **Payable Tax cannot be less than the 15%% of book profit in an assessment year**.

For calculating the tax outflow of company, first the tax is required to be calculated as per the normal provisions under the Income Tax Act. Later it needs to be compared with Tax computed on the book profit. This is known as MAT.  
After the said comparison highest tax liability is required to be paid by the company.

**Applicability & Non-Applicability of MAT**

As per section 115JB, every company registered in India is liable to pay MAT. Not only the company has to pay advanced Tax, but in case of hiding the income, the respective company shall be penalized. Previously, when MAT was introduced, it did not apply to the companies earning profit in Special Economic Zones (SEZs), but later in the year 2011, the laws were amended, and it included all such companies operating in SEZs. Every company is required to furnish a report from a certified chartered accountant stating that the book profit has been calculated under the provisions of Section 115JB.

Provisions of Section 115JB are not applicable if

* Any income that is earned through the life insurance business. [Section 115JB(5A)]
* Any shipping income liable to tonnage taxation.
* A person is a resident of a country, or a specified territory with which India has an agreement referred to in section 90(1) and the person does not have a permanent establishment in India in accordance with the provisions of such contract.
* A person is a resident of a country with which India does not have an agreement, and the person is not needed to seek registration under any law for the time being in power relating to the companies.

**MAT Credit**

When a company is liable to pay a tax under the MAT instead of regular income tax, the company is allowed to claim a credit of MAT paid over the regular Tax. According to the provision in section 115JAA, the company can carry forward and adjust the MAT credit in the subsequent years.

* MAT Credit is the amount of the difference between the MAT amount paid and the amount payable in under normal tax. When the tax is paid on the standard computation of a company’s income, it is known as normal tax.
* Previously the MAT credit was allowed to carry forward for 15 assessment years.
* MAT credit is allowed to Set Off when tax is paid on the regular income under the provisions of income tax instead of MAT. Set off is granted to the amount of difference between the tax on the total income and tax which would have been payable as per MAT under section 115JB.
* No interest is paid on the MAT credit to the company.

**Income Tax Slab of Individuals**

**FY 2022-23 (AY 2023-24)**

₹0 - ₹2,50,000 – Nil

₹2,50,000 - ₹5,00,000 5%

(tax rebate u/s 87A is available)

₹5,00,000 - ₹7,50,000 10%

₹7,50,000 - ₹10,00,000 15%

₹10,00,000 - ₹12,50,000 20%

₹12,50,000 - ₹15,00,000 25%

>₹15,00,000 30%