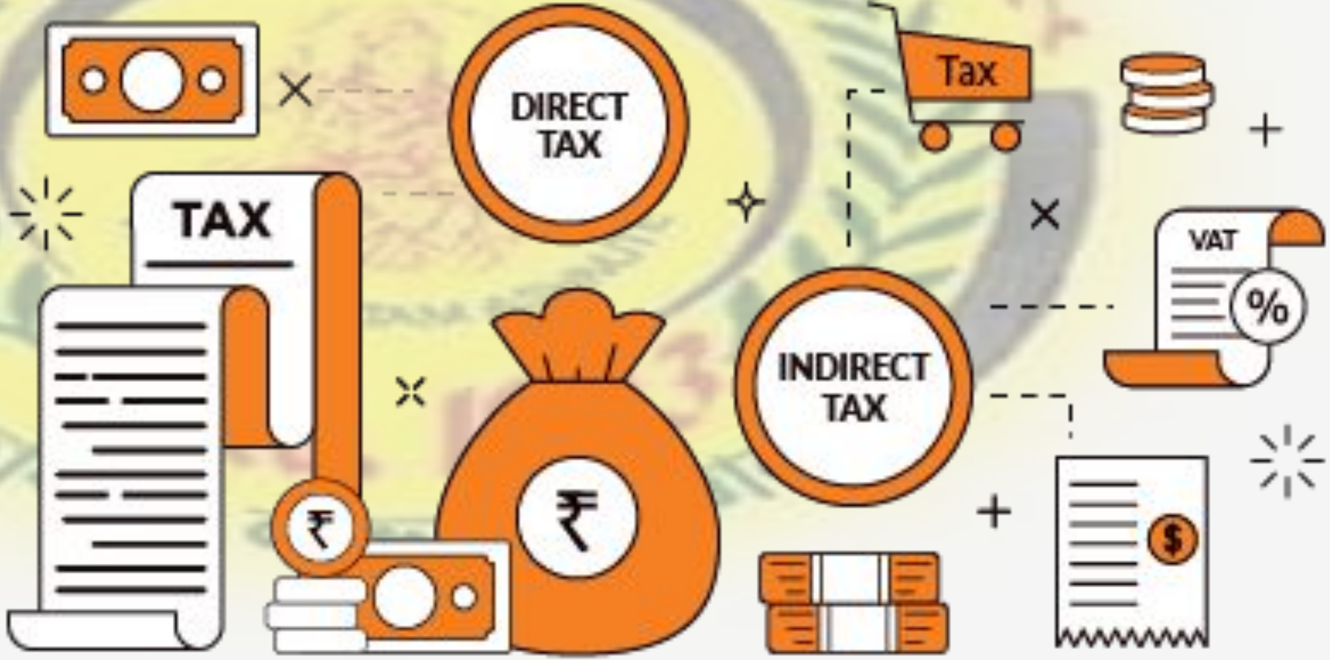
Tax Structure in India

Definition:

- Tax: A legal fee or financial charge imposed by the government on individuals or organizations.
- Purpose: Collect revenue for public infrastructure like health, education, and transport services.



Articles on Taxation in India

- 265: Imposition of tax within the purview of taxation laws and legislative power.
- 266: Deals with consolidated funds and Public accounts of states and India.
- 270: Concerns taxes imposed and divided between states and the union, excluding specific articles.
- 273: Consolidated Fund of India charged for grants under export duty on Jute products in certain states.
- 275: Deals with grants to states by the Union government for various schemes, including those benefiting Scheduled Castes and Scheduled Tribes, and the administrative development of Assam district.

What it is:

- A percentage representing the **share of a country's GDP collected in taxes**.
- Calculated by dividing total tax revenue by GDP.

What it tells us:

- **Government's ability to finance its spending:** A higher ratio indicates a stronger ability to fund public services, infrastructure, etc.
- **Tax burden on citizens:** A high ratio might suggest a heavier tax burden on individuals and businesses.
- **Economic development:** Developed countries generally have higher tax-to-GDP ratios than developing ones.

HIGH TAX TO GDP	LOW TAX TO GDP
• Financial position the country good. • It reduces a government's dependence on borrowings • Tax buoyancy is strong	• Constrains the government to spend and puts pressure on the government to meet its fiscal deficit targets.

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Adam Smith's Canons of Taxation:

Canon of Equality or Equity:

- Objective: Ensure equality of sacrifice.
- Principle: Burden of taxation distributed equitably based on the ability to pay.

Canon of Certainty:

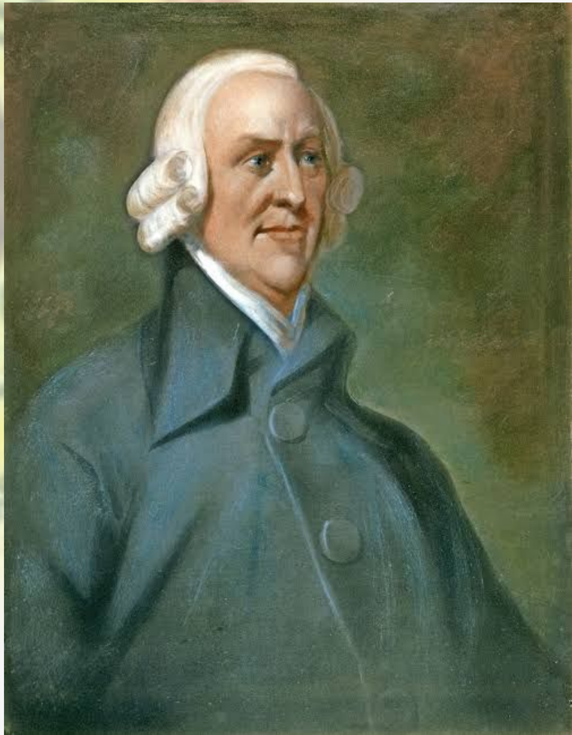
- Objective: Ensure predictability in tax payment.
- Principle: Taxes should be certain, not arbitrary, regarding time, manner, and quantity.

Canon of Economy:

- Objective: Minimize administrative costs.
- Principle: Opt for tax systems with minimal administrative expenses and efficient collection.

Canon of Convenience:

- Objective: Enhance convenience for taxpayers and the government.
- Principle: Design taxes for ease of payment and collection.



Additional Canons of Taxation:

Canon of Productivity:

- Objective: Encourage production and revenue generation.
- Principle: Taxes should incentivize production without hindering economic activities.

Canon of Elasticity:

- Objective: Ensure flexibility in tax systems.
- Principle: Tax structure should adapt to the country's changing needs, promoting social equality.

Canon of Simplicity:

- Objective: Simplify the tax system.
- Principle: Every tax should be straightforward and intelligible to facilitate easy calculation.

Canon of Diversity:

- Objective: Promote a dynamic and diversified tax structure.
- Principle: Multiple tax types spread the burden among the population, reducing overall tax incidence.

Canon of Expediency:

- Objective: Align taxes with economic, social, and political expediency.
- Principle: Taxation decisions based on the practicality and suitability of economic, social, and political factors.

Objectives of Taxation:

Primary Objective: Funding Government Expenditure: Main purpose is to provide financial resources for public spending.

Non-Revenue Objectives:

- Economic Development:
  - *Resource Mobilization:* Taxation aids in mobilizing resources for economic development.
  - *Investment Boost:* Facilitates public and private investment to enhance economic growth.
  - *Tax Planning:* Aims to increase the savings-to-national income ratio.
- Income Redistribution:
  - *Reducing Inequalities:* Through taxes, addresses income and wealth disparities in society.
- Employment Generation:
  - *Demand Stimulation:* Lowering tax rates increases disposable income, stimulates demand, and promotes employment.
  - *Multiplier Effect:* Enhanced demand leads to increased investment, income, and employment.
- Price Stability:
  - *Inflation Control:* Adjusting direct taxes helps control inflation by curbing private spending.
  - *Commodity Market:* Indirect taxes impact inflation, with higher rates reducing pressure on commodity markets.

Criteria	Direct Tax	Indirect Tax
Imposition	Directly on taxpayers' income or profits.	Levied on goods and services consumed by taxpayers.
Passing On	Cannot be shifted to another individual.	Can be shifted from one person to another.
Examples	- Income Tax (higher your income, the higher amount of tax you will have to pay)	- Service Tax
	- Corporate Tax	- Goods and Services Tax (GST)
	- Property Tax (Local)	- Excise Duty
	- Wealth Tax (Abolished)	- Customs Duty
		- Sales Tax (Subsumed under GST)
Flexibility	Offers limited flexibility in terms of adjusting tax rates based on income levels	Provides more flexibility in adjusting tax rates and structure as it applies to good and services

Criteria (Methods of Taxation)	Progressive Taxation	Regressive Taxation	Proportional Taxation
Rate Structure	Increasing rates with higher income levels.	Decreasing rates with higher income levels.	Fixed rates irrespective of income levels.
Objective	To reduce income inequality by taxing the rich more.	To promote economic growth and investment by taxing the poor less.	To maintain a neutral tax burden across income levels and productior
Example (India)	Indian Income Tax (Slab-based taxation).	No specific permanent sectors; occasional use for promotional purposes.	Goods and Services Tax (GST) in India.
Equity Consideration	Promotes social equity by ensuring the wealthy contribute more.	Can lead to increased income inequality as the burden is lower on the wealthy.	Neutral in terms of the impact on income distribution.
Flexibility	Offers flexibility in adjusting tax rates across income slabs.	May lack flexibility, applied more situationally.	Provides a stable and predictable tax environment.

Central Taxes

- Central Excise duty
- Additional duties of excise
- Excise duty levied under Medicinal & Toilets Preparation Act
- Additional duties of customs (CVD & SAD)
- Service Tax
- Surcharges & Cesses

State Taxes

- State VAT / Sales Tax
- Central Sales Tax
- Purchase Tax
- Entertainment Tax (other than those levied by local bodies)
- Luxury Tax
- Entry Tax (A11 forms)
- Taxes on lottery, betting & gambling
- Surcharges & Cesses

Types of Direct Tax

DIRECT TAXES	UNION GOVT.	STATE GOVT.
On Income	• Corporation Tax (6.81 in RS lakh crores) • Minimum Alternative Tax (MAT) • Dividend Distribution tax, Capital Gains tax.	• Agriculture tax, • Professional tax
On Assets	• Securities Transaction Tax, • Commodities Transaction Tax	• Land Revenue, • Stamp/Registration duty. • Property tax in urban areas.
On Expenditure	• Fringe Benefit Tax, • Gift Tax	

Tax on Companies

Minimum Alternate Tax (MAT):

- Application: Imposed on zero-tax companies at 18.5% of book profit.
- Purpose: Address situations where companies show nil or negative taxable income due to exemptions, deductions, and incentives.

Google Tax/ Equalisation Levy/ GAFA Tax

- To tax India revenue of foreign firms with no permanent establishments in India.
- With the intention of taxing the digital transactions -the income accruing to foreign e-commerce companies from India.
- GAFA TAX – France has taxed major companies – Google, Amazon, Facebook, Apple.

Corporate Tax Reform:

- Rates: Reduced for domestic and foreign companies, particularly for new manufacturing companies.
- Objective: Align with global rate cuts to attract investment, compete in global export markets.

Dividend Distribution Tax (DDT):

- Levied on: Dividends paid by companies to shareholders.
- Challenge: Increased tax burden for investors who pay corporate income tax, creating a pinch for investors with lower personal income tax rates.
- Recent Reform: DDT abolished, making dividend income part of the shareholders' personal income, subject to personal income tax slabs.

Types of Indirect Tax

Value Added Tax (VAT):

- Definition: Tax collected at each stage of value addition in production or distribution.
- Method: Multi-point tax collection, imposed and collected at different stages of the value addition chain.
- Objective: Eliminate cascading effect, improve purchasing capacity, ensure uniformity in state-level taxes.

Commodities Transaction Tax (CTT):

- Application: Levied on non-agricultural commodity futures at 0.01% rate.
- Purpose: Discourage excessive speculation, create parity between securities and commodities markets.
- Nature: Considered a type of financial transaction tax.

Securities Transaction Tax (STT):

- Nature: Financial transaction tax applied to transactions on domestic stock exchanges.
- Rates: Prescribed by the central government; collected for the government by stock exchanges.
- Effects: Introduced to make long-term capital gains tax zero and reduce short-term capital gains tax.

Capital Gains Tax:

Short Term Capital Gain (STCG): On assets sold within 36 months, follows normal income tax slab or 15% for specific assets.

Long Term Capital Gain (LTCG): On assets sold after 36 months, taxed at 20%, with a recent LTCCL of 10% on certain assets.

Single GST Rate:

- Suggestion:
  - Advocate for a uniform GST rate for all goods.
  - Argues progressive rates are suitable for direct taxes, not indirect taxes.
- Rationale:
  - Different rates lead to subjective interpretation and litigation.
  - A single rate expected to contribute positively to GDP.

Exemption-less Tax Regime:

- Proposed Changes:
  - Call for an exemption-less direct tax regime.
  - Eliminate artificial differences between corporate and personal income taxes.
- Benefits:
  - Reduces tax complications.
  - Streamlines administrative compliance.

Goods and Services Tax (GST) Council:

- Background:
  - Formed post the Constitutional (122nd Amendment) Bill in 2016.
  - Ratification by over 15 states and Presidential assent.
- Composition:
  - Chaired by Union Finance Minister.
  - Includes Union Minister of State (Finance) and state-nominated finance or taxation ministers.
- Functions:
  - Recommends goods and services subject to/exempt from GST.
  - Decides on GST rate slabs and model GST laws.

Recent Developments:

- 47th GST Council meeting chaired by Union Finance Minister.
- Supreme Court decision (May 2022) clarified non-binding nature of Council's recommendations.
- States like Kerala and Tamil Nadu welcomed the flexibility in accepting recommendations.

Current Framework of GST System:

- Overview:
  - Introduced through the 101st Constitution Amendment Act, 2016.
  - Subsumed excise duty, VAT, service tax, etc.
- Existing Tax Structure:
  - Central GST (CGST): Covers excise duty, service tax, etc.
  - State GST (SGST): Covers VAT, luxury tax, etc.
  - Integrated GST (IGST): Coordinates inter-state trade.
- GST Slabs:
  - Four major slabs: 5%, 12%, 18%, and 28%.
  - Additional cess on some luxury goods in the 28% bracket.
- GST Council:
  - Article 279A of the Constitution.
  - Chaired by Union Finance Minister with state-nominated ministers.
  - Decision by 3/4th majority with 2/3rd voting power for states.

GST Composition Scheme for Small Businesses (Turnover < Rs 1.5 crore)

Benefits:

- **Simple compliance:** Fewer returns, simpler record keeping, no invoice issuance.
- **Lower tax liability:** Fixed rate based on turnover.
- **High liquidity:** Lower tax payments mean more cash on hand.

Drawbacks:

- **Limited business scope:** Cannot operate in certain areas or supply specific goods.
- **No input tax credit:** Cannot claim tax paid on purchases.
- **Ineligible for e-commerce:** Cannot sell through online platforms.

GST Organizations:

- **National Anti-Profiteering Authority (NAPA):** Ensures tax benefits are passed to consumers.
- **GST Network (GSTN):** Manages the GST portal and IT infrastructure.

GST Concepts:

- **Input Tax Credit (ITC):** Reduces tax burden by offsetting tax paid on inputs against output tax.
- **Reverse Charge Mechanism (RCM):** Buyer, not seller, pays GST in specific scenarios.
- **GST Compensation Cess:** Levies tax on luxury goods to compensate states for revenue loss.
- **E-Way Bill System:** Tracks movement of goods exceeding Rs 50,000 in value.

Burden & Efficiency:

- **Cascading Effect:** Tax on tax, leading to higher effective rates.
- **Tax Buoyancy:** Responsiveness of tax revenue to economic growth.
- **Tax Elasticity:** Responsiveness of tax revenue to changes in income.

Cost & Optimization:

- **Tax Expenditure:** Revenue forgone due to exemptions, deductions, rebates.
- **Laffer Curve:** Relationship between tax rates and revenue (not always linear).
- **Pigouvian Tax:** Taxing negative externalities to discourage harmful activities.

Planning & Avoidance:

- **Tax Mitigation:** Legal strategies to minimize taxes (financial prudence).
- **Tax Avoidance:** Legal methods to reduce tax liability (e.g., deductions, credits).
- **Tax Evasion:** Illegal activity to avoid paying taxes.

Global & Illegal Activity:

- **Tax Inversion:** Shifting headquarters to low-tax countries for tax benefits.
- **Black Money:** Income earned illegally or concealed from taxes.
- **Money Laundering:** Making illegal money appear legitimate.
- **Tax Haven:** Country offering low or no tax liability.
- **Hawala:** Informal money transfer system.
- **Tax Terrorism:** Undue pressure by tax authorities using legal/extra-legal means.

Transfer Pricing:

- Setting prices for goods/services sold between related entities in different countries.
- Advance Pricing Agreements: Predetermined methodology for future transfer pricing.

Difference between Cess & Surcharge

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Feature	Cess	Surcharge
Definition	Levy on tax	Additional tax on income tax
Purpose	Specific purpose	General purpose
Applicability	All taxpayers	High-income earners only
Fund	Consolidated Fund of India	Consolidated Fund of India

Central Board of Direct Taxes (CBDT)

Function:

- Shapes direct tax policies and strategies for India.
- Oversees implementation and execution of direct tax regulations through the Income Tax Department.

Structure: Led by a Chairman and six members.

Affiliation:

- Operates within the Department of Revenue, Ministry of Finance.
- Functions under the Central Board of Revenue Act, 1963.

Key Points:

- Statutory authority responsible for direct taxes in India.
- Plays a dual role in policy and implementation.
- Headed by a Chairman and supported by six members

Key Institutions:

OECD:

- **Established:** 1961
- **Goal:** Stimulate economic progress and trade
- **Members:** 36 high-income economies (India not a member but key partner)
- **Headquarters:** Paris, France
- **Reports:** Government at a Glance, International Migration Outlook, Better Life Index

Enforcement Directorate (ED):

- **Enforces:** Foreign Exchange Management Act (FEMA) and Prevention of Money Laundering Act (PMLA)
- **Handles:** Fugitive Economic Offenders Act (FEOA) cases
- **Website:** [[invalid URL removed]]([invalid URL removed])

Financial Intelligence Unit (FIU-IND):

- **Analyzes:** Suspicious financial transactions and money laundering
- **Reports to:** Economic Intelligence Council (EIC)