GS FOUNDATION FOR CSE 2024
ECONOMY-13
FISCAL POLICY-3
TAXATION-1

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2. INTRODUCTION

- Tax is a **compulsory levy payable by an economic unit to the government without any corresponding entitlement** to receive a definite and direct quid pro quo from the government.

- **Tax Base:** Legal description of the **object with reference to which the tax is payable**. It may have time dimension like year, month etc.
    - E.g., base of the excise duty is production of commodities
    - Base of income tax is income of the individual

- **Tax Buoyancy** measures actual observed change in Tax Revenue relative to GDP
    - Tax Buoyancy = Proportionate change in the tax revenue / Proportionate change in GDP
    - Tax Buoyancy = %change in tax revenue / % change in GDP
    - Change in tax may be because of two reasons:
        1. Due to automatic increase
        2. Due to discretionary changes in tax rates or coverage or both

- **Tax Elasticity:**
    - It measures proportionate change in tax revenue without any discretionary change, relative to GDP.
    - E.g.
        - If tax rate has changed by 20%, (10% without discretion and 10% because of rate change) and If Change in GDP is 10%
            - Tax Buoyancy = 20/10 = 2
            - Tax Elasticity = 10/10 = 1

- **Classification of Taxation**: The taxation can be classified mainly into three types (1. Proportional Taxation 2. Progressive Taxation 3. Regressive Taxation)
    i. **Proportional Taxation:** Tax levied as a % of tax base irrespective of size of tax base, at a uniform rate is called as proportional tax.

    ii. **Progressive Taxation:** Tax rate increases with the increase in size of tax base.
    For e.g., under the **new tax regime**: Following are the interest rates:
    - Up to Rs 3 lakh - 0 per cent tax
    - Between Rs 3 and 6 lakh - 5 per cent tax
    - Between Rs 6 and 9 lakh - 10 per cent tax
    - Between Rs 9 lakh and Rs 12 lakh - 15 per cent tax
    - Between Rs 12 lakh and Rs 15 lakh - 20 per cent tax
    - Above Rs 15 lakh above - 30 per cent tax

    iii. **Regressive Taxes:** If the tax rate decrease with the increase in tax base it is called regressive tax. Here the % of tax rate decreases but the absolute amount of tax increases with increase in size of tax base but less than that of proportional and progressive taxation.

- **Impact of Tax**
    - Impact of tax is on its **first point of contact with the tax payers**. It is upon those who bear the first responsibility of paying it to authorities.

- E.g., Income tax -> income recipient
- Sales Tax -> seller

- **Incidence of Tax**
  - Incidence of tax is on its final resting place, i.e. those economic unit which finally bear the money burden of tax, and which are not able to pass it to others.

- **Different methods of taxation on goods**
  i. **Ad Valorem**: If tax is levied as % of the value of the goods regardless of number of units produced/sold/imported, then it is called ad valorem.

  ii. **Specific Duty:** If tax is levied at a flat rate per unit of goods.

3. TYPES OF TAXES

- There are two types of taxes namely.
  i. **Direct Tax**
  ii. **Indirect Tax**

1) DIRECT TAX

- **Impact and incidence lies on same point.** Those taxes for which burden for tax falls on the entity that is being taxed are knowns as direct taxes.

- Progressive in nature in India and all over the world and are highly elastic in nature.

- **E.g.**
  - **Income Tax:** Tax on personal income of the individuals, Hindu undivided families (HUFs), partnership firms etc.

  - **Corporate Tax:** It is levied on the company's profit income. There is not separate tax called corporate tax. It is also income tax. But the contribution of tax from corporate to the income tax is large. So, it is shown in separate head.

  - **Wealth Tax:** It is imposed on accumulated wealth or property of every individual, Hindu undivided family.
    - **Note:** It was **abolished** in the Union budget presented on 28th Feb 2015.
    - It has been replaced with **additional surcharge** on super rich with a taxable income of over 1 crore annually.
    - **Why was it abolished:** Although only a nominal amount of revenue is collected (844 crore in 2012-13), this levy creates a significant amount of compliance burden on the taxpayers as well as administrative burden on departments. Moreover, the assets which are specified for the levy of wealth Tax, being unproductive like jewellery, Luxury cars etc are difficult to be tracked.

- **Property Tax:** As per the income Tax Act of India, incomes from properties are regarded as one of the heads of income. Therefore, tax is levied on the income from property. These usually include buildings, flats, shops and land etc.

- **Securities Transaction Tax (STT)**
  - Introduced in 2004-05. It is tax imposed on transactions of securities in Stock Exchange.
  - Current STT ranges from 0.001 percent to 0.2 percent depending on the nature of transaction.

- **Commodities Transaction Tax (CTT)**
  - CTT is similar to STT, levied in India, on transactions done on the domestic commodity derivatives exchange.

  - First introduced in Budget 2008-09, but was withdrawn later as it was felt that it could have negative impact on India's nascent commodity derivative market.
  - This was that reintroduced in Budget 2013-14. But it has been done only for the **non-agriculture commodity** future at the **rate of 0.01%** (which is equivalent to the rate of equity futures)

  - **Aims/Advantages of CTT**: Discouraging **excessive speculation**, which is detrimental to the market and to bring parity between securities market and commodities market such that there is no tax/ regulatory arbitrage. The CTT also helps government in widening tax base.

  - **Other Updates**
    - **Finance Act, 2016** provided that transaction carried out in a recognized commodity exchange located in an international Financial Center, where the payment is carried out in terms of foreign currency, would be **exempt** from payment of CTT.

  - **Key recommendations**
    - A finance ministry official has called for reduction in CTT and STT as these tax rates were higher than international marketplaces such as Singapore and Hongkong.
    - Recent a NITI Aayog Committee has also recommended scrapping of commodities transaction tax on gold.

- **Minimum Alternate Tax** - see details separately.
- **Alternate Minimum Tax -** See details separately.

2) INDIRECT TAX

- If impact is on one point and incidence on some other point. It is called indirect tax.
  - These taxes are considered regressive in nature.

- But by imposing higher rate of taxes on luxury goods and lower rates of taxes on essential goods the progressiveness of indirect taxes is ensured to some extent.

– **GST** - Covered in detail separately.

– **Union Excise Duty**:
  - **Duties of Excise** on the following goods manufactured and produced in India:
    - Petroleum Crude; high Speed Diesel; Motor Spirit (commonly known as petrol); natural gas; aviation turbine fuel; and tobacco and tobacco products.
    - **Note:**
      - In addition to excise duty and customs duty levied, **National Calamity Contingent Duty (NCCD)** is levied on some of the specified tobacco products and on crude petroleum. It is credited to National Calamity Contingent Fund (NCCF) and National Disaster Relief Fund (NDRF).

– **Custom Duty:** Tax on import and export of commodities.
  - Note: Tax on export is levied very rarely. It is generally done in cases of domestic shortage of some agri goods.

– **Sales Tax/ VAT**:
  - It is a tax on sale of commodities. It is a state level sales tax. The tax is imposed on the percentage of value added. Hence, it is called VAT. **After introduction of GST** only few products like petrol and diesel are under VAT.

3) OTHER IMPORTANT ASPECTS

– **Cess:** It is a tax additionally levied as a percentage of existing tax amount for specific purpose. The tax amount collected should not be used for purposes other than the purposes for which it is meant for.
  - For e.g: **Education Cess**: It is an additional levy that is applied on basic tax liability by the government to generate additional revenue to fund primary, secondary and higher education. Apart from individuals, even corporations are required to pay this cess every year at rates determined during the annual budgets.

– **Surcharge:** A tax additionally levied as a percentage of existing tax amount, but **without any specific purpose**. It is levied if size of the tax base exceeds a certain threshold limit.
  - For e.g.: Surcharge on Income Tax of Individuals

Annual Income	**Surcharge**
Under 50 Lakh	Nil
Rs 50 Lakh to 1 crore	10%
Rs 1 crore to 2 crores	15%
Rs 2 crore to 5 crores	25%
Above Rs 5 crore	25% (From FY24)

  - **Note:** On annual income above Rs 5 crore, surcharge of 37% was applicable. But from FY24, this has been reduced to 25%. This will ensure that maximum marginal rate of tax will be reduced from **42.74%** to 39%.

- **Countervailing Duty:** To encourage export, countries give subsidy to exporters. So, the cost of production for exporters comes down. Hence, exporters are able to export to other countries at a cheaper rate. It largely affects producers of the importing country. To counterbalance (countervail) this, importing countries impose duty on imported goods to raise the price of the subsidized product to offset the lower price. This is called countervailing duty.

- **Anti-Dumping Duty:**
  - **Dumping** means exporting goods to other country in large quantity at a cheaper rate. There are two types of dumping.
    1. **Price dumping:** It means selling goods in foreign country at price lower than the price of home country.
    2. **Cost Dumping:** It means selling goods in foreign country at a price lower than cost of production. It is mainly aimed at wiping out domestic producer from the market. It is also called **predatory dumping**.
  - **Duties imposed on dumped goods is called Anti-dumping duty**.

4) LAFFER CURVE

- In economics, the Laffer curve is a representation of the r**elationship between rates of taxation and the resulting levels of government revenue**.
  - Proponent of Laffer curve claim that it illustrates the concept of taxable income elasticity - i.e., how taxable income will change in response to changes in the rate of taxation.
  - The Laffer curve postulates that no tax revenue will be raised at the extreme tax rates of 0% and 100% and that there must be at least one rate which maximizes government taxation revenue.