Taxation in India: Direct Taxes and Indirect Taxes

Tax is a payment transfer collected from individuals or any taxable entity by government of the country for the development and security of the nation. They are generally an involuntary fee or penalty or charges levied on individuals and corporations in order to finance government activities.

India has a well-developed tax structure. **The tax structure in India is classified as direct and indirect taxes.** In India, the authority to levy taxes is divided between the central government and the state governments. The central government levies direct taxes and indirect taxes. Whereas the states have the constitutional power to levy sales tax apart from various other local taxes like entry tax, octroi, etc.

Constitutional Provisions for Taxation System:

- The Indian Constitution envisage following provisions regarding taxation to avoid any disputes between the Centre and states or states vs states:
    - Clearly define Division of powers to levy taxes between Centre and state.
    - Taxes that are levied by the Centre, but they are distributed between both Centre and the state. For example: Union Excise Duty.
    - Taxes that are levied by the Centre, but they are used by the states. For example: Estate duty on property.
    - Taxes that are levied and used by the central government, but their collection is done by the states. Example- Stamp Duty
    - Taxes which are levied by the states, and they are also used by states. Example: VAT

Money collected through taxation is used by governments to carry out activities such as:

- Redistribution of wealth to meet the objective enshrined in DPSP of our Constitution
- For development and economic infrastructure — roads, ports etc
- To boost military defence
- For enforcement of law and order
- For social welfare and to make our country a welfare state.
- Social infrastructure like education, health etc
- Social security measures like pensions. Provident Fund, transfer Payment, unemployment benefits

Classification of Taxes

- **Direct Tax:**

    1. The tax that is levied by the government directly on the individuals or corporations is called Direct Taxes.
    2. The incidence of the tax and its impact will fall on the same person.

3. They are progressive in nature.
4. They are Not at all Inflationary.
5. They are levied to meet both social and economic objectives.
6. Its Social objective is the distribution of income mentioned under article 39(a) of the DPSP. If a person earns more then he should contribute more for public service by paying more tax. **Examples Property tax, Income Tax, Corporation Tax and Wealth Tax.**

- **Indirect Tax:**

1. The tax which is levied by the government on any entity (Manufacturer of goods), but later is passed on to the final consumer by the manufacturer.
2. The incidence of this indirect tax and its impact falls on different persons.
3. They are regressive in nature.
4. The objective of this tax is Only Economical. As when an indirect tax is levied on a product, both rich and poor pay taxes at the same rate. So they share the same burden despite being income difference.
5. They are inflationary. Examples -VAT, Service tax, GST, Excise duty, entertainment tax and Customs Duty.

Direct Tax

- **Income Tax:**
  - It is levied on the income earned by the individuals, Hindu undivided families or other legal people.
  - In India, it is a progressive tax.
  - To calculate it, we add income from all sources and taxed as per the income tax slabs which are mention as below:
    - if the total income exceeds Rs 50 lakh and it is below Rs 1 Crore then a Surcharge of 10% of income tax will be levied additionally.
    - if the total income exceeds Rs 1 Crore then a Surcharge of 15% of income tax will be levied additionally.
- **Corporation Tax**
  - They are levied on the income of corporate firms or industries.
  - For taxation purpose, a company is considered as a separate entity, therefore, they have to pay a separate tax apart from the personal income tax of its owner.
  - All Companies registered in India under the companies act 1956 are liable to pay corporate tax.
- **Tax on Wealth and Capital**
  - **Wealth Tax:** It was first levied in 1957. It was made on the excess of net wealth (over 30 lakhs rs) of individuals and companies. It got abolish in 2015.
  - **Gift Tax:** it was introduced in 1958. It was levied on all donations except the one given by the charitable institution. It got abolished in 1998.

- **Capital Gain Tax:** Capital gain is any profit that arises from the sale of the capital asset. The profit from the sale of any capital is taxed by the government. Capital Asset includes both moveable as well as immovable properties like land, building, house, jewellery, patents, copyrights, shares etc. they are of 2 type -
  - **Short-term capital asset**– they are those assets which are held for not more than 36 months or less.
  - **Long-term capital asset**– they are those assets that are held for more than 36 months. But from FY 2017-18 onwards – The criteria of 36 months have been decreased to 24 months in the case of immovable property being building, land and house property.

Indirect Taxes

- **Custom Duty:**
  - It is a type of indirect tax.
  - It is a duty levied by the government on exports and imports of goods.
  - Import duty is not only act as a source of revenue for the government but also used to regulate trade.
  - They are mainly levied on ad valorem basis.
  - Similar to custom duty, octroi is meant to ensure that goods crossing state borders are taxed appropriately. It is levied by the state government.
- **Excise Duty:**
  - It is basically a commodity tax as this is levied on production of goods in India. They are not levied on the sale of the product, unlike GST.
  - It is explicitly levied by the central government for all manufactured products except for alcoholic liquor and narcotics.
  - It is different from customs duty as it is applicable only to things produced in India.
  - It is also known as the Central Value Added Tax or CENVAT.
- **Service Tax**
  - It is an indirect tax levied by the government on the services provided in India.
  - It was first introduced in 1994-95 on three services. These are as follows- telephone services, general insurance and share broking.
  - Since then, the service net has been widened every year by including more and more services under it. So now we choose to have an exclusion criterion based on 'negative list.
  - It is being replaced by Goods and Service tax.
- **Value Added Tax**
  - It is a type of indirect tax introduced in the 2000s.
  - Various committees like Indirect Taxation enquiry committee on taxation recommended 'Value Added Tax' because
    - India's indirect tax structure is weak.
    - It produces cascading effects.
    - uncertainty and complexity in its structure.
    - its administration was also difficult.
  - It is a self-monitoring mechanism thus making the work of tax administrator easier and **removes distortions.**

    - VAT was then introduced in India by other states and UTs (except UTs of Andaman Nicobar & Lakshadweep) by replacing Sales Tax of States.
    - It was levied on various goods sold in the state, and the amount of the tax is decided by the state itself.
    - The State VAT existed till 1 July 2017. Then it had been replaced by GST.
- **GST (Goods and Services Tax)**
    - It is a multi-point, destination-based **indirect tax with set off for tax paid on purchases of inputs.**
    - **There is no cascading (tax on tax) effect** since there is a deduction or credit mechanism for taxes paid for the earlier inputs.
    - it is a value-added tax and consumption-based tax. Thus, the total burden of the tax is exclusively borne by the domestic consumer.
    - It is a comprehensive indirect tax levy on the manufacture and sale of goods as well as services.
    - Integration of GST in its indirect tax structure gave India a world-class tax system. It improves tax collections and enhances its tax base. It also ends the long-standing distortions of differential treatments of manufacturing and service-sector.
    - The Union Government has exempted the following indirect tax from the ambit of GST and it also has the exclusive power to levy excise duty on the manufacture or production of the following:
        - Petroleum Crude
        - Natural Gas
        - Aviation Turbine Fuel
        - High-Speed diesel
        - Petrol
        - Tobacco and Tobacco Products