TAXATION

Tax is a payment compulsorily collected from individuals or firms by government. A direct tax is levied on the income or profits of an individual or a company respectively. The word 'direct' is used to denote the fact that the burden of tax falls on the individual or the company paying the tax and can not be passed on to anybody else. For example, income tax, corporate tax, wealth tax etc. An 'indirect' tax is levied on manufacturing and sale of goods or services. It is called 'indirect' because the real burden of such a tax is not borne by the individual or firm paying it but is passed on to the consumer. Excise duty, customs duty, sales tax etc. are the examples.

Importance of taxation for the Government, economy and society

Taxation has revenue and non-revenue aims. The revenue it fetches helps government in meeting its growth goals through investment. Taxes provide funds that can accomplish

- Provision of public goods
- national defense
- enforcement of law and order
- redistribution of wealth through progressive taxation system
- economic infrastructure — roads, ports etc
- social welfare
- social infrastructure like education, health etc
- social security measures like pensions for the elderly, unemployment benefits
- To modernize the economic system like GST
- Promote savings
- Promote small scale industries
- Boost exports by making exports free of the GST burden
- Enforce good civic fiscal behavior through carrots and sticks as in the Income Declaration Scheme (IDS) 2016 and Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY)

Taxation in India

India has an elaborate federal Constitutional scheme for imposition, collection and appropriation of taxes. The central government levies direct taxes such as personal income tax and corporate tax, and indirect taxes like customs and excise duties and service tax. In 2017, however, excise duties and service tax were integrated into the Goods and Services Tax (GST) for most products. States are a part of GST though they have some residuary power to levy Value added tax (VAT) on goods like petroleum products, tax on liquor etc. States also have the power to levy direct taxes like tax on agricultural income.

Since 1991, the tax system in India has undergone substantial rationalization- reduced rates and slabs and better administration. Tax system has been simplified also to boost "Ease of doing business."

Some of the tax reforms made till 2017 are:

- Broadening the tax base to include services, fringe benefits, stock market transactions etc
- Reduction in customs and excise duties. Peak customs rate is today 10% which is imposed on 90 per cent of non-agricultural industrial goods

- Lowering of corporate tax rates to 25% over a four year period from 2015
- Wealth tax was abolished in the Union Budget (2016-2017) and integrated into the income tax of the Rs.1 cr slab
- Rationalizing the personal income tax rates and slabs starting from 1997 'dream budget'
- GST from 2017
- Use of technology for quicker processes
- Simpler procedures for greater compliance
- Safe harbor rules on transfer pricing
- Revamping the double tax avoidance treaties with many countries like Mauritius to prevent Base erosion and profit shifting (BEPS)
- Clear General anti-avoidance rules (GAAR)
- Stringent action against black money holders through disclosure schemes which have very little amnesty component(Income Disclosure Scheme (IDS) 2016 and severe monetary penalty as in Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY) so that they pay adequate tax

Direct and Indirect Tax Ratio

Total tax revenue of the Government of India includes both direct & indirect taxes. Direct taxes include personal income tax and corporation tax mainly while indirect taxes comprise of GST and Customs duties. Direct taxes come from the well off as it is a progressive tax where the richer a person/firm, the more it has to pay. It has equity built into it. Direct taxes like income tax are also 'automatic stabilisers' – when the economy grows, there is inflation, wages rice, people move into higher tax brackets and pay more taxes which reduces their spend on goods and services thus stabilizing prices. They help in stabilising economic cycles without explicit government action.

Indirect taxes on the other hand largely do not differentiate between the rich and the poor though there is a progressive element there as well as there are exemptions and there is a hierarchy of slabs. But on most essential goods, there is tax and the poor pay it. Indirect taxes also contribute to inflation and may dent savings and demand. Thus, they are relatively anti growth. In India, the relative contribution has been evolving as follows as mentioned in the Reserve Bank of India (RBI) Handbook of Statistics on Indian Economy released in September 2017:

In 1985-86, the indirect tax revenue was more than 4 times that of the direct tax revenue. The share of indirect taxes in the total tax revenue was 83% compared to the 17% share of direct taxes in 1985-86. In 30 years since then, the share of both has more or less become equal. In 2016-17, share of direct taxes was 48% in the total tax revenue compared to the 52% share of indirect taxes. In the 8 years between 2007-08 and 2014-15, the share of direct taxes in the total tax revenue was more than the share of indirect taxes. In 2009-10, the share of direct taxes was close to 60%, the highest ever till date. Starting again in 2015-16, the share of indirect taxes has overtaken the share of direct taxes.

In this context, it should be noted that when the overall tax collections of both the Centre and the States are taken into account, nearly two-third of total tax collected is accounted for by indirect taxes, implying that the tax structure in the country continues to be regressive.

While collections from direct taxes have risen in absolute terms, their contribution to India's total tax revenue has fallen in percentage terms. Also, direct taxes have been growing at a slower pace than indirect taxes.

The reason for the surge in indirect taxes is two fold: service tax base increased and also the rate-being 18% under the GST regime since 2017. Also, with the dramatic drop in the international crude prices since 2015, GOI found an opportunity and need to increase the excise duties on petroleum products steeply.

Tax to GDP ratio

When the economy grows, there is greater personal prosperity, corporate profits and consumption of goods and services. All of them add to tax collections and thus the Tax: GDP ratio increases. GOI's gross tax collections (total amount that it collects which includes the share of States and UTs) are estimated at 11.3% of GDP for FY2018. When we add the taxes and duties of States and local bodies, India's tax-to-GDP ratio becomes 16.6%. Gross tax collections will statistically come down from 2017-18 as states are collecting their own GST. In 2015, tax revenue (including social contributions) in the EU-28 stood at 40.0 % of GDP, and accounted for around 89 % of total government revenue. In comparison, the combined tax to GDP ratio in other BRICS countries was higher - Brazil (35.6%), South Africa (28.8%), Russia (23%), and China (19.4%).Some countries, like Sweden, have a high tax-to-GDP ratio (as high as 54%). USA's is 25.4%. France has a tax to GDP ratio of 45% while Denmark as is pegged at 48.6%. Among the BRIC countries, Brazil has a tax to GDP ratio of 33.4% while Russia is at 34.8%. But experts say that most developed countries have a higher per capita income and therefore the ability to pay higher taxes.

The relatively low ratio in India is because we are a developing country; there is a large informal sector; agricultural income is exempt; there are so many other tax exemptions (tax expenditure); parallel economy; and also, tax machinery is not sufficiently capacity-built.

Low ratio handicaps the state from spending on social social sector and infrastructure. India spends on an average about 3.4 percentage points less vis-a-vis comparable countries on health and education Economic Survey 2015-16 said that India needs to increase its tax-GDP ratio, and spend more on health and education. When tax revenues grow at a slower rate than the GDP of a country, the tax-to-GDP ratio drops.

Since 2016-17, formalization of economy has become the focus with demonetization and GST. There are more people filing tax returns; more digital payments; those evading tax earlier can not do so any more as the government relies on big data garnered from demonetization. GST makes compliance higher due to input tax set off.

Due to demonetization, as many as 1.26 crore new taxpayers were added in 2016-17. The I-T department launched Operation Clean Money to clamp down on unaccounted money funnelled into bank accounts, post-demonetisation.

Number of Tax Payers 2017

In India a large section of people come from agriculture, BPL and small enterprises who are not liable to pay tax as their income falls below the exemption limit. Due to Tax Deduction at Source

(TDS), many more people are paying tax even though many of them may not be filing their tax returns. That is, not everyone who pays tax files returns. The government added 9.1 million new taxpayers in 2016-17.This is expected to significantly boost the government's tax revenue. India had only 55.9 million individual return filers at the end of 2015-16.

Not everyone who pays files returns pays tax. Many file returns to show that they have no taxable income.

Broadening Tax Base

Tax base encompasses all that is taxed- incomes, profits, manufacture, sale, import etc. While vertical equity demands that rich are taxed harder and luxury goods as well, horizontal equity demands that all transactions except the very essential ones be taxed. The more the actions that are taxed, the larger the base. Since 1991, government has been broadening the base starting from 1994 when the service tax was introduced. Following have been the steps

- STT
- CTT
- Fringe benefit tax
- MAT
- GAAR
- Limitation of benefit clause in the DTAAs
- Demonetization
- Transfer pricing and APAs
- GST
- Expanding the coverage of provisions relating to Tax Deduction at Source (TDS) to more transactions
- Quoting of permanent account number made compulsory for many transactions so more people can be brought into tax net

Tax Amnesty Schemes

There may be people who do not comply with the tax laws. That is they evade taxes. Governments make amnesty schemes for them come clean by paying taxes at the current rates or any other rate which is beneficial to the assesse even as the government collects tax revenue that can be used for the socio-economic development of the country. It is called tax amnesty scheme. Those who comply with such a scheme are not taken up criminally. Dome schemes do not have any penalty. Some have it, the latter being disclosure schemes essentially where the amnesty part if minimal (not being criminally proceeded against). The schemes that were launched in 2016 are mainly disclosure schemes: IDS 2016 and PMGKY.

IDS 2016

Income Declaration Scheme, 2016 was an amnesty scheme that was as a part of the 2016 Union budget to unearth black money and bring it back into the system. Lasting from 1 June to 30 September, the scheme provided an opportunity to income tax and wealth tax defaulters to avoid litigation and become compliant by declaring their assets, paying the tax on them and a penalty of 45% thereafter.

Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY)

It is an amnesty scheme launched by the Government of India in December 2016 on the lines of the Income declaration scheme, 2016 (IDS) launched earlier in the year. A part of the Taxation Laws (Second Amendment) Act, 2016, the scheme provides an opportunity to declare unaccounted wealth and black money in a confidential manner and avoid prosecution after paying tax, interest and a fine of 50% on the undisclosed income. An additional 25% of the undisclosed income is invested in the scheme which can be refunded after four years, without any interest.Valid from December 16, 2016 to May, 2017, the scheme can only be availed to declare income in the form of cash or bank deposits in Indian bank accounts and not in the form of jewellery, stock, immovable property, or deposits in overseas accounts.

While the rationale is appealing for the amnesty schemes, they carry a moral hazard: those who do not pay continue not to pay and those who did, may be de-motivated.

Operation Clean Money 1 and 2

Income Tax Department (ITD) initiated Operation Clean Money in January 2017. Initial phase of the operation involves e-verification of large cash deposits made during 9th November to 30th December 2016. Data analytics were used for comparing the demonetisation data with information in ITD databases. In the first batch, around 18 lakh persons have been identified in whose case, cash transactions do not appear to be in line with the tax payer's profile. Operation Clean Money 1 began on January 31 and ended on February 15.As part of the first phase of Operation Clean Money, the CBDT had identified 17.92 lakh persons for e-verification of large cash deposits.

In the second phase of 'Operation Clean Money' launched in April 2017 with an aim to detect black money generation post demonetisation, the I-T department used information received under the Statement of Financial Transactions (SFT) from banks to identify additional cases: persons whose tax profiles were found to be inconsistent with the cash deposits made by them during the demonetisation period.

Direct Taxes Code (DTC)

The Direct Taxes Code (DTC) is a proposal by the Government of India (GOI) to simplify the direct tax laws in India. DTC aims to introduce new provisions and revise, consolidate and simplify the structure of direct tax laws in India into a single legislation. DTC will I replace the Income-tax Act, 1961 and other direct tax legislations. DTC 2010 was introduced in the Indian Parliament in 2010 but it lapsed with the dissolution of the 15th Lok Sabha in 2014. However, without the DTC, many changes have been brought about in the direct tax regime in the country in the three years till 2017:

1. Wealth tax was abolished
2. Union Budget 16-17, GOI presented a plan to reduce the corporate tax rate from 30% to 25% in four years to make India's tax rates globally competitive
3. Reduction in corporate tax rate for MSMEs to 25% from 30% to make them competitive
4. General Anti Avoidance Rules (GAAR)
5. Place of Effective Management (POEM) rule as a test to determine residency for tax purposes
6. Changes in DTAAs

In the 2017 Rajaswa Gyan Sangam, PM mentioned the need to overhaul the direct taxes framework.

Inverted Duty Structure

Normally, there should be lower tax on raw material so that it can be imported and value added to produce the final product that can be sold at home or exported. That helps "Make in India". It also promotes exports. On the other hand, higher import duty on the raw materials and intermediates than on the finished product is called inverted duty structure. It puts the domestic manufacturers at a disadvantage making them uncompetitive within the domestic market and in global markets.

India levies one of the highest duties on import of raw materials and one of the lowest duties on import of finished rubber goods.This inverted duty structure is leading to a surge in import of finished goods. Of the total import of finished goods, 80-90 per cent is avoidable as domestic rubber manufacturing units have the capability to meet the demand, but low import duties on rubber products especially under FTAs (free trade agreements) have led to indiscriminate imports in the country.

Reducing the customs duty on raw material for the pharmaceutical, electronic and automobile sectors is important for the same reason.

Such anomalies discourage value-addition by domestic manufacturers and encouraged imports.

FTAs may lead to inverted duty structure with duties for final products being lower from FTA partners compared to duties for the raw materials imported from non-FTA countries. This acts as a disincentive to local manufacturing which is not competitive against FTA imports because of the inverted duty structure phenomenon.

Tax Expenditure

Tax expenditure refers to revenue forgone as a result of exemptions and concessions (direct and indirect tax). It was introduced for the first time in 2006-07 Union Budget. The revenue foregone due to tax incentives in 2015-16 is estimated at nearly 6 lakh crore. Such exemptions have been justified for promoting balanced regional growth; dispersal of industries; neutralisation of disadvantages on account of location; and incentives to priority sectors, including infrastructure. They are also given to the middle class to build houses; senior citizens for their relief; women for buying houses etc.

Since the amount is large and so many of the incentives may have lost their utility and need, it is suggested that some should be dropped. They should be subject to a sunset clause, as tax exemptions often create pressure groups for their perpetuation. While some may be justified as they enhance investment and generate more taxes for the government, others are not.

Such exemptions and concessions can distort resource allocation and stunt productivity. They also result in a multiplicity of rates, legal complexities, classification disputes, litigation etc. If these exemptions are rationalized, they can help the government spend more on social and infrastructure and help reduce the fiscal deficit.

However, some such incentives are necessary. For example, the 2016 Start Up policy that gives breaks for such firms.

Tax Havens

A tax haven is a country or territory where certain taxes are levied at a low rate or not at all. Individuals and/or corporate entities can find it attractive to move themselves to areas with reduced or nil taxation levels. This creates a situation of tax competition among governments. The important features of a tax haven arte:

- nil or nominal taxes;
- lack of effective exchange of tax information with foreign tax authorities, that is, personal finance information is not shared with other countries
- no requirement for a substantive local presence; and

Bermuda, Panama, Ireland, Singapore, the Cayman Islands, Monaco, Luxembourg and Hong Kong are among 45 territories blacklisted by the Organisation for Economic Co-operation and Development and threatened with punitive financial retaliation for being tax havens.

Panama and Pradise Papers

The Panama Papers are 11.5 million leaked documents that detail financial and attorney–client information for more than 214,488 offshore entities that contain personal financial information about wealthy individuals and public officials dealing in shell corporations that were used for illegal purposes, including fraud, tax evasion, and evading international sanctions.

The Paradise Papers is a set of 13.4 million confidential electronic documents relating to offshore investment. The documents originate from the offshore law firm Appleby. They contain the names of more than 120,000 people and companies who put their legal and illegal money in funds based in Cayman Islands and Bermuda - tax havens.

Tobin Tax

James Tobin, an economist, proposed in 1972 a worldwide tax on all foreign exchange transactions- when foreign capital enters a country and when it leaves. The aim is to check speculative flows. Long term investment – generally FDI, will not suffer as it does not invest for speculative (short term) reasons like FIIs.

Tobin justified the tax on two grounds: First, it would reduce exchange rate volatility and improve macroeconomic performance. Second, the tax could bring in revenue to support for development efforts or exchange rate stabilization.

The defining characteristic of a Tobin tax is that the tax is levied twice- once when one acquires foreign exchange, and again when one sells the foreign exchange.

The south East Asian currency crisis (1997) is partly attributed to the 'dynamics of hot money'(portfolio investments or FII flows). That gave further justification for the Tobin tax.

Tobin tax can be imposed only if all the countries accept the proposition. Otherwise, FIIs can go to countries where the tax is not imposed.

India does not prefer it as we need foreign inflows as we are a CAD country and don't have surplus.

In the EMU, there is a proposal to see a microtax levied at 0.1% on share and bond transactions, and 0.01% on deals involving complex securities such as derivatives. It is called the Financial Transaction Tax. The FTT, or "Tobin tax" as it is also known is a "Robin Hood tax", - collected from speculators and used for rescuing the financial system when there is such a need. India has a similar tax though not for the same purpose- securities transaction tax (STT) and commodities transaction tax (2015)

Due to currency volatility and stock market stocks in China in 2015-16, there is a proposal that Tobin tax be imposed. China may be able to afford such a tax as FII exposure is limited in China and it has huge surpluses of forex reserves.

India can not afford Tobin tax as we need foreign currency. We need to contain volatility by other means encouraging FDI and relatively limiting FPI though FPI is also very important for liquidity in capital market.

Pigovian Tax

The Pigovian tax is imposed on transactions that have a negative externality. For example, pollution. Externality means impact of one person's actions on the well being of an outsider (bystander or third party). For example, the seller and consumer of cigarettes together will harm the third person with pollution. Also, exhaust fumes from automobiles. Positive externality refers to a good effect on the third party. For example, restoration of historic buildings, research into new technologies, libraries etc. Carbon tax is one example in the context of the need to discourage fossil fuels and encourage renewable sources due to climate change threat. Supreme Court in 2015 imposed an 'Environment Compensation Charge' (ECC) on commercial vehicles entering Delhi.

Carbon tax (called Clean Environment Cess from 2017) is levied in India since 2010 at the rate which is Rs.400 per tonne on Coal, Lignite and Peat in order to finance and promote clean environment initiatives, funding research in the area of clean environment or for any such related purposes.It is imposed on coal produced in India or imported into India. This is in line with the principle of "polluter pays".

In many countries carbon taxes are levied also on other fossil fuels like petroleum, natural gas etc.

Base Erosion and Profit Shifting (BEPS)

BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity. It means, a company shifts its headquarters to a jurisdiction like Mauritius or Ireland where tax rates are low only to avoid taxes. Although some of the schemes used are illegal, most are not. It is a huge loss of tax revenue to the governments of the countries where these companies actually carry out their economic activity. This undermines the fairness and integrity of tax systems because businesses that operate across borders can use BEPS to gain a competitive advantage over enterprises that operate at a domestic level. Moreover, when taxpayers see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.

BEPS is of major significance for developing countries like India due to their significant reliance on corporate income tax, particularly from multinational enterprises. India suffers from BEPS due to double taxation avoidance agreements (DTAA) being misused, transfer pricing issues etc. India modified its DTAA with Mauritius to tackle the BEPS issues.

Tax abuse not only weakens efforts to fight poverty but also weakens the fiscal base needed for sustainable economic development.

OECD has a BEPS inclusive framework in which many countries are participants including India. It consists of measures ranging from common approaches which will facilitate the convergence of national practices, and best practices.The Inclusive Framework on BEPS brings together over 100 countries and jurisdictions to collaborate on the implementation of the OECD/ G20 Base Erosion and Profit Shifting (BEPS) Package.

United States Foreign Account Tax Compliance Act (FATCA) is a similar example. The Foreign Account Tax Compliance Act (FATCA) is a 2010 United States federal law requiring all non-U.S. ('foreign') financial institutions (FFIs) to search their records for customers from U.S. and to report the assets and identities of such persons to the U.S. government. India agrees with it.

Transfer Pricing and APA

Transfer pricing is the setting of the price for goods and services sold between related legal entities within an enterprise. For example, if a subsidiary company sells goods to a parent company or vice versa , the price of those goods paid by the parent to the subsidiary or the opposite is the transfer price.The Indian Transfer Pricing Code prescribes that income arising from international transactions or specified domestic transactions between associated enterprises should be computed having regard to the arm's-length price. An arm's-length price for a transaction is what the price of that transaction would be on the open market. The need for the Code is because of the profit shifting practices followed by the MNCs. For example, an MNC has a subsidiary in India and elsewhere. It sources from and supplies to the subsidiaries in all the countries. The goods and services are same but the prices are shown differently depending upon the tax rates in the countries. The corporate tax rates are high in India. Therefore, the price of goods sold by the MNC to Indian subsidiary is shown higher in India to show less profit and thus less tax outgo. Thus, transfer pricing is generally done in a way as to show high profit in countries where the corporate tax rate is low and low profits/losses where the rate is high. Therefore, transfer pricing norms existing today need to be rationalised so that the tax revenues that are due to the government are not eroded. Tax evasion and money laundering has to be checked by tightening the transfer pricing regime.The solution is advance pricing agreements (APA).

An APA refers to an agreement between the taxpayer and the tax authorities on the pricing of an existing or proposed transaction between related parties. Any taxpayer can file an application for an APA, along with details of the transaction and the proposed pricing for such transaction. The APA programme enables the taxpayers and the revenue authorities to interact, negotiate and come to a conclusion on the pricing of the transaction in question. If the taxpayer and the revenue authorities agree to a particular price, they may enter into an agreement, which would be valid for a period of five years. If, however, for some reason, they do not reach a consensus, they may not sign the agreement.It helps avoid disputes with the tax authorities over transfer pricing. The APA scheme, which was introduced in 2012, tries to provide certainty to taxpayers in transfer pricing by specifying the method of pricing and setting the prices of international transactions in advance. It applies to foreign MNCs and Indian MNCs.

Double Taxation Avoidance Agreement (DTAA)

Double taxation is the levying of tax by two or more jurisdictions on the same declared income (in the case of income taxes), asset (in the case of capital taxes), or financial transaction (in the case of sales taxes). Double taxation is avoided by DTAAs where countries affected enter into a tax treaty which sets out rules to avoid double taxation.

A DTAA is a tax treaty signed between two or more countries. Its objective is that tax-payers in these countries can avoid being taxed twice for the same income. A DTAA applies in cases where a tax-payer resides in one country and earns income in another. It is both fair as well boosts investment and growth.DTAAs also provide for concessional rates of tax in some cases.

For instance, interest on NRI bank deposits attract 30 per cent TDS (tax deduction at source) normally. But under the DTAAs that India has signed with several countries, tax is deducted at only 10 to 15 per cent. Many of India's DTAAs also have lower tax rates for royalty, fee for technical services, etc.

Favourable tax treatment for capital gains under certain DTAAs such as the one with Mauritius have encouraged a lot of foreign investment into India. Mauritius accounted for $93.65 billion or one-third of the total FDI flows into India between 2000 and 2016. It has also remained a favoured route for foreign portfolio investors. But the problem is DTAAs led to round tripping: India money goes out to come back through the DTAA countries to avoid paying taxes. Even foreign companies which are not DTAA companies route their investments through the DTAA jurisdictions only for tax avoidance purposes. They are called "mailbox companies." This leads to loss of tax revenue for the country.

2016 India-Mauritius Protocol

In 2016, India and Mauritius signed a Protocol to amend the 1982 India-Mauritius Double Taxation Avoidance Agreement (DTAA) It will have an impact on the India-Singapore DTAA as the capital gains tax exemption provided therein is linked to the benefits available under the 1982 IndiaMauritius DTAA. The 2016 protocol says that India has the right to tax the capital gains in India for investments coming from Mauritius from 2017. Investments made before 1 April 2017 have been grandfathered (continue to enjoy the benefits) and will not be subject to capital gains taxation in India. Where such capital gains arise during the transition period from 1 April 2017 to 31 March 2019, the tax rate will be limited to 50% of the domestic tax rate of India. However, the benefit of 50% reduction in tax rate during the transition period shall be subject to the Limitation of Benefits Article. Taxation in India at full domestic tax rate will take place from financial year 2019-20 onwards.

Limitation of benefits

DTAAs may contain an article intended to prevent "treaty shopping," which is the inappropriate use of tax treaties by residents of third states. These limitation on benefits articles deny the benefits of the tax treaty to residents that do not meet certain tests.

They are aimed against any attempts of round-tripping and money laundering activities.The LOB clause limits treaty benefits to those who meet certain conditions including those related to business, residency and investment commitments of the entity seeking benefit of a Double Taxation Avoidance Agreement (DTAA).

India-Mauritius Limitation of Benefits (LOB): The benefit of 50% reduction in tax rate during the transition period from 1st April, 2017 to 31st March, 2019 shall be subject to LOB Article, whereby a resident of Mauritius (including a shell / conduit company) will not be entitled to benefits of 50% reduction in tax rate, if it fails the main purpose test and bonafide business test. A resident is deemed to be a shell / conduit company, if its total expenditure on operations in Mauritius is less than Rs. 2,700,000 in the immediately preceding 12 months.

This LOB clause will have the effect of bringing substance to companies which want to be tax resident in Mauritius.

POEM

To determine the residential status of foreign companies, the Finance Act 2015 introduced the concept of place of effective management or POEM. If a company's place of effective management is India, it will be treated as an Indian resident and its global income will be taxable in India. The aim of POEM is not to attack Indian multi-nationals which are doing business outside India. But it is to target shell companies set up for retaining income outside India although effective control and management of affairs is located in India.

General Anti Avoidance Rules (GAAR)

General anti-avoidance rule (GAAR) is an anti-tax avoidance Rule of India. It came into operation from 1 April 2017- assessment year 2018-19. It allows tax officials to deny tax benefits, if a deal is found without any commercial purpose other than tax avoidance. Thus, it seeks to prevent tax evasion in the guise of tax planning. There are firms and individuals who either minimize tax payment or completely avoid it by taking advantage of the rules in the book. But government says that it is not acceptable as the entire event is planned only to avoid taxes as was done by the Vodafone when it signed the deal outside the country with Hutch and put up a corporate veil for the operation just to avoid paying taxes. Even while on the face of it, it is legal, GOI applied the doctrine of "look through" and not "look at" and ordered them to pay tax as tax avoidance in this case is tax evasion. There were no clear rules for the GOI order and there was a demand that there be clear GAAR rules. As a result GOI made the rules framed by the Department of Revenue under the Ministry of Finance. It applies to transactions made specifically to avoid taxes as detailed above. Investments made up to March 31, 2017 shall not be subjected to GAAR. It is to be applied on those claiming tax benefit of over Rs 3 crore.

GAAR was first proposed in 2010, targeting transactions made specifically to avoid taxes by companies such as Vodafone and Hutchison Essar. It applies to a company in case of abuse of treaty for gaining undue tax benefit.The rules are aimed at improving transparency in tax matters and help curb tax evasion.

The proposal to apply GAAR will be vetted first by the Principal Commissioner/Commissioner of I-T and at the second stage by an Approving Panel headed by a judge of High Court.

Adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner.

Tax Information Exchange Agreements (TIEA)

The purpose of Tax Information Exchange Agreements (TIEA) is to promote international co-operation in tax matters through exchange of information.

They provide for the exchange of information relating to a specific criminal or civil tax matter under investigation.In simple terms, the tax departments of one State may assist that of the other State, with information which may be utilized in collecting the due share of taxes of the latter State, as per its laws and procedure, India has TIEAs with many countries.

The objective of agreement is to promote international cooperation in tax matters through exchange of information. The nature of information varies from agreement to agreement. In 2016, after the Panama Papers' expose, Panama had said that it was ready to share information with India on tax evaders named in the Panama Papers, but this was possible only after the two countries signed a TIEA.The Indian government is now strongly pursuing a tax information exchange agreement (TIEA) with Panama, official sources said.

According to the Panama Papers' expose in April 2016, at least 500 Indians are reportedly said to have held offshore accounts/equity interest in offshore entities in tax havens.

In 2016, Panama signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MAC), which is now seen as "gold standard" for co-operation in tax administration. However, under the MAC, Panama is not taking up information exchange obligations automatically, but on request. The commitment to automatic exchange remains only with those countries with which Panama decides to do so bilaterally, Panama Government had said in 2016.

The MAC is the most comprehensive multilateral instrument available for all forms of tax co-operation to tackle tax evasion and avoidance, and guarantees extensive safeguards for the protection of taxpayers' rights. Already 98 other countries, including India, and jurisdictions have joined the Convention.

Panama has been the one of the most popular domicile for the anonymous shell companies controlled by the powerful.

Service Tax

Service tax was first imposed in 1994. In the Seventh Schedule to the Constitution, under Article 246, the item relating to "taxes on services" was not specifically mentioned in any entry either in the Union List or in the State List. However, Entry 97 of the Union List empowers Parliament to make laws in respect of any other matter not enumerated in List II (State List) or List III (Concurrent List), including any tax not mentioned in either of those lists. Since "taxes on services" is not there in any of the lists, service tax was levied by the Central Government in exercise of the powers under Entry 97 of the Union List.

The 88th amendment to the Constitution (2004) inserted in the Union List (List I) entry No. 92C — 'taxes on services'. The amendment was never notified and so it never came into effect. 101st Constitution Amendment Act 2016 that introduced GST deleted Art.92C as services are a part of GST for which there is an entirely new regime put in place from 2017.

Goods and Services Tax (GST)

Goods and Services Tax is a comprehensive, multi-stage, destination-based tax that will be levied on every value addition. It absorbs many indirect taxes and duties into a single consolidated tax. It is levied on the supply of goods and services. It provides set off for tax paid on inputs which removes cascading (tax on tax) effect as there is deduction or credit mechanism for taxes paid for the inputs. The tax is levied on the value added and on consumption only. Total burden of the tax is exclusively borne by the domestic consumer. Exports are not subject to GST.

The term multi stage requires elaboration. Each final commodity is the result of value addition from raw material stage to the final sale to the consumer which goes through many stages which also involve not only physical value addition but also by way of storage, distribution and sale. At every stage tax is paid and under GST that is returned (credited) when it is shown that value is further added and the good resold.

Destination based means that goods are taxed where they are sold to the consumer and not where they are made. That is, if goods are made in Gujarat and sold in Telangana, they are taxed in Telangana where the consumer pays it. The manufacturing state gains by its prosperity which creates creates a big market for its own goods and services within its geography. Its apprehensions about losses are take care of by the central government commitment to compensate and also by a portion of the IGST that the centre levies and shares with it.
Both Centre and States will simultaneously levy GST across the value chain. Centre would levy and collect Central Goods and Services Tax (CGST), and States would levy and collect the State Goods and Services Tax (SGST) on all transactions within a State.

The Centre would levy and collect the Integrated Goods and Services Tax (IGST) on all inter-State supply of goods and services. There will be seamless flow of input tax credit from one State to another. Proceeds of IGST will be apportioned among the States.

With the 101 CAA 2016 being in place, the centre passed laws to levy CGST and IGST. Similarly, all states will have to pass a simple law on SGST. These laws will specify the rates of the GST to be levied, the goods and services that will be included, the threshold of the turnover of businesses to be included, etc.

India introduced VAT (earlier name was sales tax) at the state level in 2005. In 2002 union excise duties were renamed Central Vat (Cenvat). But when states called their sales tax Vat, centre reverted to the earlier name of excise duty to prevent confusion. The earliest form of Vat was however taken in 1986 in the form of Modvat- modified VAT that included set off for a few commodities only and was confined to excise duties only.

Need for GST

Pre-GST, India had a plethora of taxes at the central and state level making it a cumbersome system. States had different rates. Lack of uniformity of rates created confusion and deterred investment. Apart from the cumbersomeness, it lacked rationality. Tax is collected by the government in general to continue to provide public and special goods. Where there is value addition, there should be tax. But when there is tax on tax, it violates rationality of taxation and also is against growth, price stability, allocative efficiency of financial resources etc. It is called cascading effect as the tax base for further taxation is irrationally higher.

Thus, GST is needed to forge a common domestic market, removing multiplicity of taxes, eliminating the cascading effect of tax on tax, making the prices of the Indian products competitive and, above all, benefiting the end consumers by attracting investment of scale.

Eliminating a multiplicity of existing indirect taxes would simplify the tax structure, broaden the tax base as there is incentive to pay taxes due to the attraction of input tax credits and thus create tax buoyancy to enable government to consolidate the fiscal system and provide for greater resources for social sector.

By lowering business costs and transaction costs, it would boost economic growth and increase exports and bring India in line with practices in many developed economies. Reducing production costs would make exporters more competitive.

Black money and evasion will reduce as GST is transparent. Also because all taxable businesses have to register with the government and thus become formal. Alcohol, petroleum,real estate and electricity do not come under GST.

GST and Revenue Neutral Rate

An important issue in the Goods and Services Tax was the rates of central and state GSTs to be levied. Tax rates should be "revenue neutral". This implies that the rates set under the new GST regime are such that they get the same revenue as the pre-GST regime. That is, the rates are not meant to lead to revenue loss or gain. However, over time the revenue productivity is expected to increase due to better compliance; higher levels of administrative efficiency; and increased productivity of the economy due to its rationality and transparency.

Estimation of revenue-neutral rate requires consensus on the exemption list, number of tax rates to be levied and the list of goods and services to be included in different rate categories.

There are three terms in this filed: Standard rate is what applies to most goods and services. Fitment rate is the rate that applies to a class of goods and services which is the tax bracket in which they fall. Revenue neutral rate is the rate that brings the same revenue as the pre-GST regime.

GST and Fiscal Autonomy Issues

Constitutional amendments are required to enable the Centre and the states to impose tax on the same base of goods and services. Currently, the states cannot impose tax on services. They also can not impose tax on manufacturing of goods. Centre cannot levy tax sales tax.

States feel that their fiscal autonomy is being eroded for the following reasons:

- they are surrendering the power to tax sales
- they can not change rates according to their fiscal needs
- all states can not have the same rates as it violates respect for federal diversity
- centre may not compensate the states fully

The position of states is rejected on the other points for the following reasons

- centre is also surrendering and sharing its powers regarding service tax and union excise duties

- states are free to tax sin goods like liquor and also the petroleum products

It is said that like VAT, GST would also increase the revenue of the states as they will have powers to impose tax on services which are growing at a rapid pace.

Thus, there is mutual surrender of powers to a uniform national taxation system where both gain. Apprehensions of loss of fiscal autonomy by states and central dominance is misplaced. This is a quintessential case of cooperative federalism and is an example of pooled sovereignty.

Constitution (101st) Amendment Act, 2016

The Act seeks to amend the Constitution to introduce the goods and services tax (GST). Consequently, the GST subsumes various central indirect taxes including the Central excise duty, additional excise duties, service tax, additional customs duty (CVD) and special additional duty of customs (SAD), etc. It also subsumes state Value Added Tax (VAT)/sales tax, central sales tax, entertainment tax, octroi and entry tax, purchase tax and luxury tax, etc.

Central and State government powers for GST: It inserts a new Article 246A in the Constitution to give the central and state governments parallel power to make laws on the taxation of goods and services.

Integrated GST (IGST): However, only the centre may levy and collect GST on supplies in the course of inter-state trade or commerce and imports. The tax collected would be divided between the centre and the states in a manner to be provided by Parliament, by law, on the recommendations of the GST Council.

GST Council: The President must constitute a Goods and Services Tax Council within sixty days of this Act coming into force. GST council examines issues relating to goods, services tax and make recommendations to the Union and the States on parameters like rates, exemption list and threshold limits. The Council shall function under the Chairmanship of the Union Finance Minister and will have the Union Minister of State in charge of Revenue or Finance as member, along with the Minister in-charge of Finance or Taxation or any other Minister nominated by each State Government.

Composition of the GST Council

The GST Council is to consist of the following three members:

(a) the Union Finance Minister (as Chairman),
(b) the Union Minister of State in charge of Revenue or Finance, and
(c) the Minister in charge of Finance or Taxation or any other, nominated by each state government.

Functions of the GST Council

These include making recommendations on:

- taxes, cess and surcharges levied by the centre, states and local bodies which may be subsumed in the GST;
- goods and services which may be subjected to or exempted from GST;
- model GST laws, principles of levy, apportionment of IGST and principles that govern the place of supply;

- the threshold limit of turnover below which goods and services may be exempted from GST;
- rates including floor rates with bands of GST;
- special rates to raise additional resources during any natural calamity;
- special provision with respect to Arunachal Pradesh, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand; and
- Any other matters relating to the goods and services tax, as the Council may decide.

The Goods and Service Tax Council shall recommend the date on which the goods and service tax be levied on petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas and aviation turbine fuel.

Resolution of disputes: The GST Council may decide upon the modalities for the resolution of disputes arising out of its recommendations.

Compensation to states: Parliament shall, by law, provide for compensation to states for any loss of revenues, for a period which may extend to five years. This would be based on the recommendations of the GST Council. This implies that (i) Parliament must provide compensation; and (ii) compensation cannot be provided for more than five years, but allows Parliament to decide a shorter time period.

Goods And Services Tax (GST) And The Changes It Makes In The Fiscal Federal Scheme of Division Of Powers

GST shows the Centre and States working together on a sustained basis to incrementally but irreversibly transforming the domestic indirect tax landscape in a manner to make the country a common market for more investment and prosperity. Both the centre and states had to forego some of their earlier constitutional powers for the historic compromise: The Centre left its exclusive power to tax manufacture of goods (i.e. Excise) and provision of services (i.e. Service Tax), and the States gave up their exclusive power to tax sale of goods (sales tax / VAT). Both the Centre and the States agreed to share their powers to achieve uniformity.

The Constitution of India has been amended accordingly- 101 CAA 2016. In the early part of the last decade, initially Empowered Committee of State Finance Ministers and later the GST Council became useful. Under the GST regime, the Centre & States will act on the recommendations of the GST Council. The participation of all States and Centre in the framing of GST laws has led to Harmonisation of GST laws across the country.

Main Constitutional changes

1. Art.246A *(explained separately)*
2. GST Constitution Amendment Act omits Entry 92 and 92C from the Union List and Entry 52 and 55 of the State List of the Seventh Schedule.
   - 92 of Union list – Taxes on the sale or purchase of newspapers and on advertisements published therein.
   - 92C of Union List – Taxes on services
   - 52 of State List – Taxes on the entry of goods into a local area

- 55 of State List – Taxes on advertisements other than advertisements published in the newspapers and advertisements broadcast by radio or television.

Rationale for Art.246A

The Seventh Schedule to the Constitution classifies all areas under three lists for the purpose of making laws: the Union List, which enumerates subjects under the sole purview of Parliament; the State List, which has items to be legislated by state legislatures; and the Concurrent List, which has subjects that can be legislated upon by both Parliament and state legislatures. In case of Concurrent List subjects, if there is a contradiction on any specific provision in laws made by Parliament and a state legislature, the central law will override the state law.

Currently, the power to impose some of the taxes is distributed among the three Lists: Union list of the Constitution (e.g., excise duty) while that for some others are in the State List (e.g., sale tax). Therefore, the Constitution needs to be amended to enable the enactment of a uniform law. When we consider the amendments possible, many ways may be suggested. We need to see each one of them and see why they are not acceptable. One simple method is to move the power to impose all these taxes to the Union List. The Centre can then levy the tax, and a method of redistributing the tax to states can be formulated, by the FC. This is the process used in the case of central taxes such as income tax, which are then pooled and redistributed according to the recommendation of the Finance Commission. However, this methodology has some major drawbacks. States have no say in the rate of tax that is levied under this process, and may be unwilling to give up this power. Also, there is a risk that the state in which the transactions occur and where tax is collected may not get their proportional share of the tax pool at the time of redistribution. This will reduce the incentive for states to formulate policies that lead to higher economic activity as they might not benefit from the potential increase in tax revenue. Another choice would be to move the power to impose GST to the Concurrent List.

However, this move would have the same drawbacks discussed above because Parliament will have the power to make laws that override any law made by state legislatures. A third approach was adopted in the 101 CAA 2017 after extensive consultation with the Empowered Committee of State Finance Ministers. The Act removes several of these taxes from the three Lists and creates a new Article (Art.246A) of the Constitution to deal with GST. Both Parliament and state legislatures will have the power to make law, but unlike the Concurrent List items, Parliament will not have the power to make a law that overrides a state law. This applies to all goods and services other than six items: petroleum crude, diesel, petrol, natural gas, aviation turbine fuel and alcohol for human consumption. In case of inter-state commerce, Parliament will make law, the central government will collect the tax, and the tax collected will be apportioned between the centre and states according to law made by Parliament.

This formulation could lead to non-uniform taxes across states defeating a key objective of a national GST. In order to address this possibility, the Bill creates a GST Council composed of the union finance minister and the minister of state in charge of revenue, and finance ministers of all states which will determine the GST rates by consensus.

How GST scores over the pre-GST regime

Multiplicity of Taxes: Presently, the Constitution empowers the Central Government to levy excise duty on manufacturing and service tax on the supply of services. Further, it empowers the State

Governments to levy sales tax or value added tax (VAT) on the sale of goods. This exclusive division of fiscal powers has led to a multiplicity of indirect taxes in the country. In addition, central sales tax (CST) is levied on inter-State sale of goods by the Central Government, but collected and retained by the exporting States. Further, many States levy an entry tax on the entry of goods in local areas. Taxes by Union Government, State Governments and the local governments have resulted in difficulties and harassment to the tax payer. He has to contact several authorities and maintain separate records for each of them.

Complex: The taxes are levied by central government as well as state government. So, a person has to maintain accounts which will comply all the applicable laws. This multiplicity of taxes at the State and Central levels has resulted in a complex indirect tax structure in the country that is ridden with hidden costs for the trade and industry.

Cascading effects of taxes: In current indirect tax structure in India, there is cascading of taxes due to 'tax on tax'. No credit of excise duty and service tax paid at the stage of manufacture is available to the traders while paying the State level sales tax or VAT, and vice versa. Further, no credit of State taxes paid in one State can be availed in other States. Hence, the prices of goods and services get artificially inflated to the extent of this 'tax on tax'.

Multiple Compliance: A business person might have to comply with multiple compliance in terms of indirect taxes in India.

IGST

IGST is a part of Goods and Service Tax (GST)

IGST means Integrated Goods and Service Tax. IGST is charged when movement of goods and services from one state to another. For example, if goods are moved from Tamil Nadu to Telangana, IGST is levied on such goods. Under the GST regime, an Integrated GST (IGST) would be levied and collected by the Centre on inter-State supply of goods and services. Under Article 269A of the Constitution, the GST on supplies in the course of inter State trade or commerce shall be levied and collected by the Government of India and such tax shall be apportioned between the Union and the States in the manner as may be provided by Parliament by law on the recommendations of the Goods and Services Tax Council.

Dual GST

India adopted a dual GST model, meaning that taxation is administered by both the Union and State Governments. India is a federal country where both the Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislation. Both the levels of Government have distinct responsibilities to perform according to the division of powers prescribed in the Constitution for which they need to raise resources. A dual GST will, therefore, be in keeping with the Constitutional requirement of fiscal federalism. It satisfies the urge for autonomy by both the Centre and States. Dual GST threw up the challenge of taxpayers interface with tax administration and thus cross-empowerment was worked out.

GST and Cross-empowerment

The cross-empowerment model allows taxpayers to restrict their interaction to a single tax authority for central GST, state GST and integrated or IGST. Central and state GST are two components of a single GST levied on intra-state sales, while IGST will apply to inter-state sales. The division of GST taxpayers between the centre and states will be done horizontally with states getting to administer and control 90% of the asseesses below Rs 1.5 crore annual turnover, and the remaining 10% coming under the Centre. The Centre and states will share control of assessees with annual turnover of over Rs 1.5 crore in 50:50 ratio and thus each tax payer will be assessed only once and by only one authority.

Anti-profiteering clause of GST

Section 171 of the CGST Act (and the corresponding provisions of the state GST Acts) creates the obligation on businesses to pass on to the recipients any reduction in the rate of tax or the benefit of input tax credit by way of a commensurate reduction in prices. For example, in November 2017, the 23rd meeting of the GST Council reduced rates on many goods and services: If the firms do not pass it on, they are liable for penal action.

These rules prevent entities from making excessive profits by not passing such reliefs. Since the GST, along with the input tax credit, is eventually expected to bring down prices, a National Anti-profiteering Authority (NAA) is to be set up to ensure that the benefits that accrue to entities due to reduction in costs is passed on to the consumers. Also, entities that hike rates inordinately, citing GST as the reason, will be checked by this body.

NAA will investigate the complaints, the procedure to be followed in investigations and the powers given to the authority.

Once the registered entity, which has profiteered illegally, is identified, it can be asked to — one, reduce prices if it has hiked prices too much and, two, if price reduction due to GST rate relief has not been passed on to customers, to return to the customer the sum equivalent to the price reduction along with 18 per cent interest from the date the higher sum was collected. The authority can impose penalty on the profiteer or cancel its registration.

The rules however do not lay down the formula based on which the extent of profiteering can be determined. This task has been left to the NAA.

Many countries that have adopted GST such as Singapore and Australia witnessed a spurt in inflation after implementation. This clause is relevant thus.

GSTN

Goods and Services Tax Network, (GSTN) is a Section 8 (under new companies Act, not for profit companies are governed under section 8), non-Government, private limited company. It was incorporated in 2013. The Government of India holds 24.5% equity in GSTN and all States of the Indian Union, including NCT of Delhi and Puducherry, and the Empowered Committee of State Finance Ministers (EC), together hold another 24.5%. Balance 51% equity is with non-Government financial institutions. The Company has been set up primarily to provide IT infrastructure and services to the Central and State Governments, tax payers and other stakeholders for implementation of the Goods and Services Tax (GST). The Authorised Capital of the company is Rs. Ten crore.

Besides, GST being a destination based tax, the inter- state trade of goods and services (IGST) would need a robust settlement mechanism amongst the States and the Centre. This is possible only when there is a strong IT Infrastructure and Service backbone which enables capture, processing and exchange of information amongst the stakeholders (including taxpayers, States and Central Governments, Accounting Offices, Banks and RBI).

GST And Petro-Products

Petroleum products are not included in the GST. That is taxes paid on them are not returned eventually. They are not eligible for set off. States have refused the central government's appeal to bring petroleum products under the ambit of Goods and Services Tax (GST).

Taxes constitute more than 50% of the price consumers pay for petrol and diesel. States, which charge VAT are reluctant to move away from the present tax regime unless the Centre promises special annual grants. Different states have different rates of VAT.It's the GST Council, the highest decision-making body of the indirect tax regime, that has the final word on the inclusion of petroleum productsFor the states, moving to the GST for petroleum products could amount to a "loss" in revenue. While the Centre collects Rs.21.48 as excise duty, states charge value added tax (or VAT, which varies from state to state, ranging between 25% and 48%) along with 25p as pollution cess with a surcharge. In 2016-17, the combined revenue collected from the petroleum sector was Rs.463,089 crore, according to figures available with the ministry of petroleum and natural gas. Of this, states' share was Rs.189,587 crore.

Under GST, even if petrol and diesel are charged at the highest slab of 28%, states, which get a substantial chunk of their revenue from the sector, will stand to lose considering they will only get 14% of it — much lower than the present rate of VAT. States say that taking the autonomy of taxing petroleum products away from the states will hurt their exchequer. States have freedom to change the VAT on petrol and diesel. But under the GST, this flexibility will go.

With highest VAT and the surcharge in the country, Maharashtra government earns over Rs.20,000 crore a year from taxes on petrol and diesel. Centre also does not want to integrate petroproducts into GST as that will erode its fiscal resources. The Centre has been under pressure from the opposition as well as consumers for the steady surge in fuel prices.

Jammu and Kashmir and GST

Unlike in the case of the rest of India, the power to levy state taxes in J&K are not part of the Constitution of India's 7th schedule. Instead, it is part of the J&K Constitution.

Hence, the 101st Constitution amendment, laying the GST framework, is not applicable to the Himalayan state. It applies to J and K only when their legislature passes it. The resolution passed by the state assembly recently adopting GST was to address this issue and facilitate adoption of GST.

It will be very beneficial for state of Jammu and Kashmir and the estimate is that tax revenue will increase .Importing states like J&K stand to benefit from the GST as there will be no cascading effect of taxes, resulting in fall in prices of commodities. It will also benefit as its goods will be cheaper for trade in Indian market due to the input tax credit they enjoy like others. The entire market of India can be tapped. In case of revenue loss, there is compensation for 5 years also.

GST Benefits Small Entrepreneurs And Small Traders

The pre-GST threshold prescribed in different State VAT Acts below which VAT is not applicable varies from State to State. It was Rs. 5 lakhs for a majority of bigger States and a lower threshold for others. A uniform State GST threshold across States is desirable. Under the provisions of the GST, traders with an annual turnover less than 20 lakh are exempt for the Goods and Services Tax. This raising of threshold will protect the interest of small traders. A Composition scheme for small traders and businesses has also been introduced under GST. Both these features of GST will adequately protect the interests of small traders and small scale industries.

Threshold exemption is built into a tax regime to keep small traders out of tax net. This has three-fold objectives:

a. It is difficult to administer small traders and cost of administering of such traders is very high in comparison to the tax paid by them.

b. The compliance cost and compliance effort would be saved for such small traders.

c. Small traders get relative advantage over large enterprises on account of lower tax incidence.

In its working however, the GST troubled the small businessmen for which remedies were announced in October and November 2017. Composition Scheme is an important feature of GST to protect the interests of small traders and small scale industries. Small and new taxpayers generally find it difficult to comply with so many rules. Hence, the government has introduced the concept of Composition Scheme. Now there is an option for small and new taxpayer to opt for Composition scheme and have lesser compliance burden. Also, a taxpayer opting for composition scheme has to pay tax at a nominal rate. A taxpayer whose turnover is below Rs 1 crore can opt for Composition Scheme. In case of North-Eastern states and Himachal Pradesh, the limit is now Rs 75 lakh.

HSN Code in GST

Harmonized System of Nomenclature, or HSN, was conceived and developed by the World Customs Organization (WCO) with the vision of classifying goods from all over the World in a systematic and logical manner. It is a six digit uniform code that classifies more than 5,000 products and is accepted worldwide. These set of defined rules is used for taxation purposes in identifying the rate of tax applicable to a product in a country. It is also used to determine the quantum of product exported or imported in and out of a country. It is a crucial feature to analyze the movement of goods across the World. It is a combination of different sections, further drilled down to chapters, which are further classified into headings and sub-headings. The resultant figure is the six-digit code. HSN is widespread and is adopted in more than 200 countries, covering a 98% of goods in the World. It is by far, the best logical system of classification and identification adopted in International Trade. It has helped in reducing efforts and costs related to complex procedures of International Trade. HSN (Harmonized System of Nomenclature) is a 6-digit code for identifying the applicable rate of GST on different products as per GST rules.

Components of GST

There are 3 types of taxes under GST: CGST, SGST & IGST.

- **CGST:** Collected by the Central Government on an intra-state sale (Eg: Within Andhra Pradesh)
- **SGST:** Collected by the State Government on an intra-state sale (Eg: Within Andhra Pradesh)
- **IGST:** Collected by the Central Government for inter-state sale (Eg: Andhra Pradesh to Kerala)

Tax slabs under the GST 2017

The government has categorised items in five major slabs for different goods and services - 0%, 5%, 12%, 18% and 28%.

Goods and Services Tax (Compensation to States) Act, 2017

The Goods and Services Tax (GST) is a transformational and historic reform whose effects are exppected to be positive but it is untested and so has generated anxieties among the states that they may incur losses. That made them bargain hard for compensation from centre in case of losses. It is a destination-based tax, so is viewed as being to the advantage of the consuming states and to the detriment of the producing states like Maharashtra, Tamil Nadu, Gujarat, Haryana, and Karnataka. These latter wanted a suitable compensation formula.States demanded full compensation for five years and the Centre agreed.

Government needs extra revenue to compensate the states, and so the GST Council decided to impose additional cesses for five years on certain goods over and above the highest tax bracket of 28%. These goods on which cess will be levied include tobacco products, coal, motor vehicles, which include all types of cars, personal aircraft, and yachts.

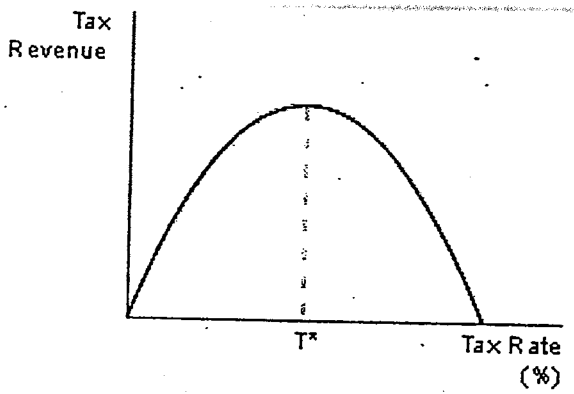
These additional cesses, however, will be removed after five years and the states incurring losses would have to find alternative sources of revenue.

The percentage of the additional cess changes from good to good.Both intra-state and inter-state supplies of goods or services would attract GST cess over and above the applicable CGST, SGST, and IGST rates.

Clean Environment Cess of GOI , India's carbon tax which was a source of funding clean energy projects and to combat climate change and which was collected -Rs. 400 a tonne on domestic and imported coal- to make up the National Clean Energy Fund, will go into the GST Compensation Fund, according to Goods & Services (Compensation to States) Act, 2017, in a schedule.

Laffer Curve

Developed by Arthur Laffer, this curve shows the relationship between tax rates and tax revenue collected by governments. The chart below shows the Laffer Curve:



The Laffer curve has been debated in the country since 1997-1998 Budget reduced rates and slabs in the income tax regime in the country.

Source and spend of rupee

Where does the rupee come from?

- 19% of the rupee comes from corporation tax
- 16% from Income Tax
- 9% from Customs duty
- 14% from Excise duty
- 10% from Service tax and other taxes
- 10% Non-tax revenue
- 3% Non-debt capital receipts
- 19% from borrowing and other liabilities

How is the rupee spent?

- 11% of the rupee goes to Central plan
- 18% on Interest
- 9% on Defence
- 10% on Subsidies
- 5% on other Non-Plan Expenditure
- 24% on States' shares
- 13% on Non Plan Grants
- 10% Plan assistance to state and Union territories

Minimum Alternative Tax (MAT)

Normally, a company is liable to pay tax on the income computed in accordance with the provisions of the Income Tax Act, but the profit and loss account of the company is prepared as per provisions of the Companies Act. There were large number of companies who show book profits as per their profit and loss account (according to the Companies Act) but do not pay any tax by showing no taxable income as per provisions of the Income Tax act. Although the companies show book profits and may even declare dividends to the shareholders, they do not pay any income tax. These companies are popularly known as Zero Tax companies. In order to bring such companies under the income tax act net, MAT was introduced in 1996. They are required to pay MAT at 18.5% of the book profit.

Book profit is profit which is notional: when assets appreciate, their value in the book goes up but the same is not realized as they are not sold. It is also called unrealized gain or unrealized profit or paper gain or paper profit.

Rajaswa Gyan Sangam

The Central Board of Direct Taxes (CBDT) and the Central Board of Excise & Customs (CBEC) have been holding annual Conferences of senior officers for a number of years. In 2016, for the first time, a joint Conference of the two Boards was held under the umbrella of "Rajaswa Gyan Sangam" which was inaugurated by the Hon'ble Prime Minister. Same was held in 2017 too.

The objective of the Conference is to enable a two-way communication between the policy-makers and the senior officers in the field offices with a view to increase revenue collection and facilitate effective implementation of law and policies. Issues arising in implementation of policies and strategies to achieve targets in core functional areas are discussed. Such issues *inter alia* include HR issues, Litigation Management, Strategies for Revenue Maximisation, Tax Evasion, Taxpayer Services, GST and Reforms and Modernisation.

Tax Reforms in India

Since the beginning of the last decade as a part of the economic reforms programme, the taxation system in the country has been subjected to consistent and comprehensive reform.

The need for the tax reforms arises from the fact that

- tax resources must maximised
- international competitiveness must be imparted to the Indian economy
- transaction costs must be reduced
- the high-cost nature of Indian economy needs to be corrected so that compliance increases,equity improves and investment flows

On the direct tax front, the reforms are the following:

- Reduction and rationalization of rates
- Simplification of procedures
- Strengthening of e-administration
- Widening of the tax base
- Exemptions are gradually being withdrawn.
- Corporate tax reforms since 2015
- Wealth tax abolished in 2015 and many more as seen above

Indirect Taxes

- Reduction in the peak tariff rates- 10% is the peak customs duty today
- The number of slabs has come down drastically
- GST etc

Some Terms

Dividend Distribution tax

Companies giving dividend have to pay tax on the amount distributed as dividend.

Withholding tax

It means withholding of tax from certain payments including interest, salaries paid to employees, professional fee, payments to contractors etc at the time of making the payment. It is the same as TDS.

Capital gains tax

It is the tax on the gains made from buying and selling assets like land, shares etc.

If the gain is made in the assets held for over three year (one year for shares) , it is called long term capital gain and taxed. For shares, there is no long term capital gains tax. Short term capital gains tax is always more to encourage investment as distinct from speculation.

Presumptive Tax

Presumptive tax the estimated income method of assessment for certain categories of businesses is prevalent in several countries. Presumptive taxation involves the use of indirect means to ascertain tax liability which differs from the usual rules based on the taxpayer's accounts. It is used to indicate that there is a legal presumption that the taxpayer's income taxable to a certain extent.

The reason for the presumptive tax may be that in a number of businesses the assessees do not maintain books of accounts or the books of accounts maintained are irregular and incomplete. It was introduced in India in the early nineties for traders but was withdrawn as the success rate was low.

Wealth Tax

When income accumulates into wealth, it gets taxed after a point. Wealth tax is levied only in respect of specified non-productive assets such as residential houses, urban land, jewellery, bullion, motor cars etc. Union Budget 2015-16 abolished wealth tax and instead levied an additional surcharge of 2 per cent on individuals with taxable income of Rs 1 crore and above.

Securities Transaction Tax

Introduced in the Union Budget 2004-2005, it is a tax on the value of all the transactions of purchase of securities that take place in a recognised stock exchange of India. It is meant to make up revenue loss from the abolition of long term capital gains tax.

Commodities Transaction Tax

Commodities transaction tax (CTT) is a tax similar to Securities Transaction Tax (STT). CTT aims at discouraging excessive speculation

Fringe Benefit Tax (FBT)

Fringe benefits are usually enjoyed collectively by the employees and cannot be attributed to individual employees singly. They are taxed in the hands of the employer who may or not pass it on to the employee. Examples are transport services for workers and staff, gym, club, etc.

The rationale for levying a FBT on the employer lies in the inherent difficulty in isolating the 'personal element' where there is collective enjoyment of such benefits and attributing the same directly to the employee. This is so especially where the expenditure incurred by the employer is ostensibly for purposes of the business but includes, in partial measure, a benefit of a personal nature. Consequent to abolition of fringe benefit tax in 2009, certain benefits taxed earlier as fringe benefits in the hands of the employer would now be taxable as perquisites in the hands of the employees.

Perquisites

Perquisites are benefits in addition to normal salary to which employee has a right by virtue of his employment. To put it simply or 'perks' as they are called colloquially, are benefits generally in cash/kind, received by an employee by virtue of his employment.

Perks are taxable as a part of salary as per the India income tax laws and includes:

- the value of rent-free accommodation
- the value of any concession in the matter of rent respecting any accommodation provided etc
- car
- club membership
- travel

Tax-incidence: It shows the entity on whom tax is imposed. It is different from the tax burden as the latter refers to the one who actually bears it- the consumer in the case of indirect taxes. For direct taxes, both fall on the same entity. Tax on petrol is paid by te consumer while the seller is officially responsible to deposit with the government.

Tax Base: The value of goods, services and incomes on which tax is imposed. When we speak of the tax base being broadened, they mean a wider range of goods, services, income, etc. has been made subject to a tax. In the case of income tax, the tax base is taxable income. Some kinds of income are excluded from the definition of taxable income, such as savings. For sales tax, the tax base is the value/volume of items that are subject to tax; essential goods, for example, are not part of the tax base.

Tax Shelters: Any technique which allows one to legally reduce or avoid tax liabilities. It is a way in which the taxpayer can invest his income in a particular kind of investment that gives tax concessions.

Tax planning, avoidance and tax evasion: There are provisions in the law that allows one to save and invest in a manner that leads to reduction in taxable income. If these provisions are used for reducing tax liability, it is called tax avoidance. It is lawful to take all available tax deductions. It is the same as tax planning for tax mitigation.

Tax evasion, on the other hand, is a punishable offence. Tax evasion involves failing to report income, or improperly claiming deductions that are not authorized. It creates black money.

But as mentioned earlier in the chapter, certain types of tax avoidance can be considered evasion as in the case of Vodafone.

Hidden taxes: are taxes that are concealed in the price of articles that one buys. Hidden taxes are also referred to as implicit taxes. The most well-known form of the hidden tax is the indirect tax. Examples of hidden taxes are import duties.

Consumption tax

A consumption tax is a tax on spending on goods and services. The tax base of such a tax is the money spent on consumption. Consumption taxes are indirect, such as a sales tax or a value added tax.

Proportional, progressive and regressive tax

An important feature of tax systems is whether they are proportional tax (the tax as a percentage of income is constant over all income levels), progressive tax (the tax as a percentage of income rises as income rises), or regressive tax (the tax as a percentage of income falls as income rises). Progressive taxes reduce the tax incidence on people with smaller incomes, as they shift the incidence disproportionately to those with higher incomes.

Specific duty: Weight or quantity or number is the basis for taxation.

Ad Valorem- A Latin term meaning "according to worth," referring to taxes levied on the basis of value. Taxes on real estate and personal property are ad valorem. Luxury goods are taxed higher even if they weigh the same or number the same as ordinary goods.

Compound duties are a combination of value and other factors based on which tax is imposed.
Excise Duty: Excise duty is a tax on manufacture and is levied on the manufacture of goods within the country.

Customs Duty: When goods are imported or exported, customs duty is imposed and collected by the Union Government. Peak customs duty today is 10%.

Negative income tax: Subsidy is a negative income tax. It is a taxation system where income subsidies are given to persons or families that are below the poverty line. The government sends financial aid to a person who files an income tax return reporting an income below a certain level. It is advocated by economist Milton Friedman in 1962.

Tax Buoyancy: It refers to the percentage change in tax revenue with the growth of national income. That is, growth-based increase in tax collections.

Tax Elasticity: Tax elasticity is defined as the percentage change in tax revenue in response to the change in tax rate and the extension of coverage. Buoyancy, on the other hand is the response to economic growth when the base increases but there is no change in the rate.

Tax Stability: It means no frequent changes and continuity of policy in a predictable and transparent manner. Although revenue from different taxes varies from year to year, revenue stability is desirable because it makes it easier for a government to build a credible spending and borrowing plan for the year ahead. Taxes whose revenue is relatively stable contribute to overall revenue stability. Market players also can plan better.

SRIRAM's IAS

Receipt Budget, 2017-2018

ABSTRACT OF RECEIPTS

(In ₹ crores)

	2015-2016 Actuals	2016-2017 Budget Estimates	2016-2017 Revised Estimates	2017-2018 Budget Estimates
REVENUE RECEIPTS				
1. Tax Revenue				
Gross Tax Revenue	**1455648.11**	**1630887.81**	**1703242.94**	**1911579.46**
Corporation Tax	453228.33	493923.55	493923.50	538744.73
Taxes on Income	287637.12	353173.68	353173.70	441255.27
Wealth Tax	1079.26	...	...	...
Customs	210338.00	230000.00	217000.00	245000.00
Union Excise Duties	288072.89	318669.50	387368.58	406900.00
Service Tax	211414.25	231000.00	247500.00	275000.00
Taxes on Union Territories	3878.26	4121.08	4277.16	4679.46
Less - NCCD transferred to the National Calamity Contigency Fund/National Disaster Response Fund	**6136.39**	6450.00	**6450.00**	**10000.00**
Less - State's share	**506192.86**	**570336.59**	**608000.31**	**674565.45**
Centre's Net Tax Revenue	**943318.76**	**1054101.22**	**1088792.63**	**1227014.01**
2. Non-Tax Revenue				
Interest receipts	25378.32	29620.43	18149.03	19020.73
Dividend and Profits	112127.15	123780.05	153222.38	142430.49
Other Non Tax Revenue	112662.67	168181.29	161997.07	125788.20
Receipts of Union Territories	1538.27	1339.33	1401.81	1517.65
Total Non Tax Revenue	**251706.41**	**322921.10**	**334770.29**	**288757.07**
Total Revenue Receipts	**1195025.17**	**1377022.32**	**1423562.92**	**1515771.08**
3. Capital Receipts				
A. Non-debt Receipts				
1. Recoveries of loans and advances@	30834.75	10634.31	11070.86	11932.25
2. Miscellaneous Capital Receipts	42131.69	56500.00	45500.00	72500.00
Total	*72966.44*	*67134.31*	*56570.86*	*84432.25*
B. Debt Receipts*				
3. Market Loans	404049.95	425180.87	347218.54	348226.40
4. Short term borrowings	50692.71	16648.84	18629.59	2002.00
5. External Assistance (Net)	12748.34	19094.42	14873.00	15789.00
6. Securities issued against Small Savings	52464.96	22107.91	90376.57	100157.16
7. State Provident Fund (Net)	11858.33	12000.00	13000.00	14000.00
8. Switching/Buy Back of Securities	...	...	...	...
9. Other Receipts (Net)	-12201.90	25676.70	9948.40	53512.69
Total	519612.39	520708.74	494046.10	533687.25
Total Capital Receipts (A+B)	**592578.83**	**587843.05**	**550616.96**	**618119.50**
4. Draw-Down of Cash Balance	**13170.07**	**13195.08**	40227.10	**12844.20**
Total Receipts (1+2+3+4)	**1774433.93**	**1951670.29**	**1933952.78**	**2121046.38**
Receipts under MSS (Net)	...	20000.00	...	...
@ excludes recoveries of short-term loans and advances from States, loans to Government servants, etc.	11035.05	11861.04	50615.00	51375.01

* The receipts are net of payment