TAXATION IN INDIA: Concepts and Policies

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. 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.

Funds provided by taxation are used by governments to carry out the functions such as:

- military defense
- enforcement of law and order
- redistribution of wealth
- economic infrastructure — roads, ports etc
- social welfare
- social infrastructure like education, health etc
- social security measures like pensions for the elderly, unemployment benefits

Taxation System in India

India has a well developed tax structure. Being a federal country, the authority to levy taxes is divided between the central government and the state governments. The central government levies direct taxes such as personal income tax and corporate tax, and indirect taxes like customs duties, excise duties and central sales tax (CST). CST is assigned to the States in which it is collected. (Art.269). The states have the constitutional power to levy sales tax apart from various other local taxes like entry tax, octroi, etc.

Taxation has always played an important role in the formulation of the government's economic policy. Taxation policy in a developing country like India can play an important part to raise resources for growth; to bring in reduction in inequalities; to direct growth in backward regions; to reduce consumption of luxury goods; to direct investment into small scale sector; to promote savings etc. In the wake of the economic reforms, the tax structure and procedures have been rationalised and simplified. Since 1991, the tax system in India has undergone substantial rationalization- reduced rates and slabs and better administration.
Some of the changes 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%
- Lowering of corporate tax rates to 30%
- Rationalizing the personal income tax rates and slabs starting from 1997 `dream budget'
- Sales tax reforms at the State level as a preliminary step towards their integration into GST
- introduction of VAT from 2005 at the state level; GST is expected to be introduced in 2011
- Simplifying income tax return filing procedures. For example, Saral, Towards better taxpayer services, in 2011-12, the IT department has introduced simple and user friendly

SAHAJ (Form) for individual salary tax-payers; SUGAM for small tax-payers availing presumptive tax scheme.(For presumptive tax, see ahead)

Tax revenue as a percentage of GDP decreased initially, after reforms began in 1991, as rates came down and growth of economy was not very robust. Compliance also did not increase proportionate to rate reduction. Since the Tenth Plan period, there has been a consistent rise in tax collections but it dipped due to global financial crisis of post-2008 period. GOI expects Rs.1.24 lakh crore for service tax collection during 2012-13 due to wider coverage and higher rate (12%).In 2011-12, the tax-GDP ratio stood at 5.5 per cent for direct taxes and 4.4 per cent for indirect taxes.

Government expected to increase its gross tax revenue by 19.5% to Rs 10.77 trillion in the financial year 2012-13.

The gross tax revenue is estimated at 10.6% of the gross domestic product (GDP) in the Budget estimates 2012-13.

Revenue from corporation tax is the highest contributor at Rs 3.73 trillion to the government's total revenue, while income tax, customs, union excise duties, and service tax yielded Rs 1.95 trillion, Rs 1.86 trillion, Rs 1.94 trillion and Rs 1.24 trillion, respectively.

Direct tax revenue growth is estimated at Rs 5.7 trillion, up 13.9% and indirect tax revenue growth is estimated at Rs 5.05 trillion, up 26.7%.

The government targeted a net tax revenue of Rs 7.71 trillion in 2012-13, after devolution to the states.

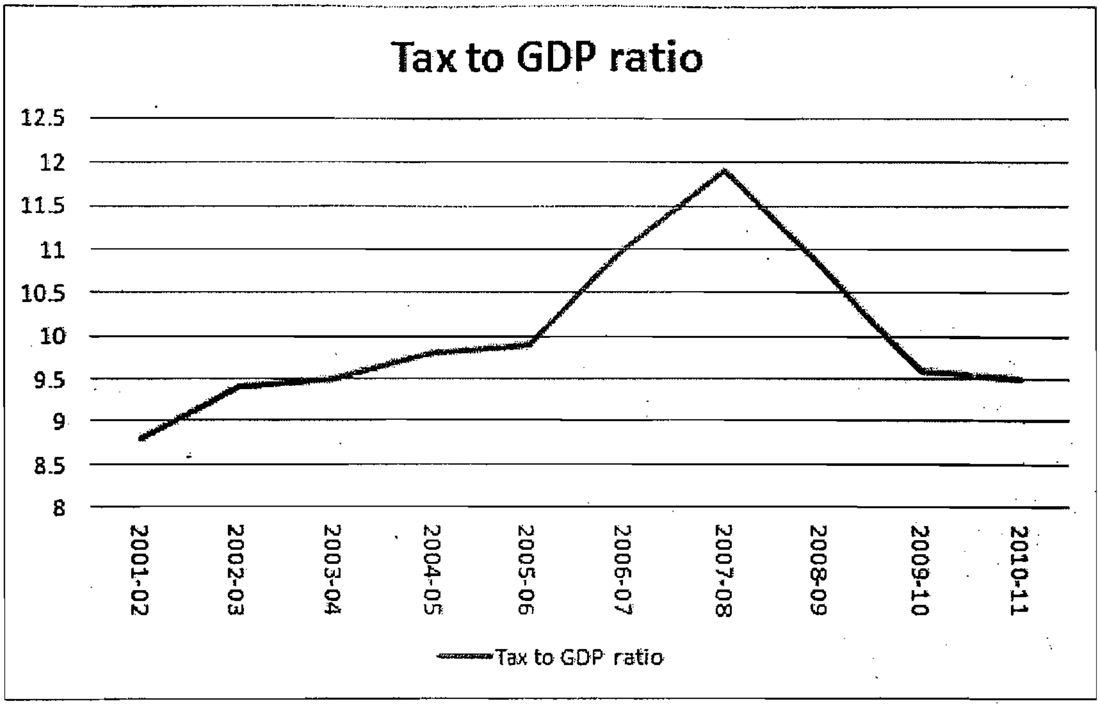
The non-tax revenue receipts are estimated at Rs 1.64 trillion and non-debt capital receipts are estimated at Rs 416.5 billion.

Expenditure:
The government's total expenditure is budgeted at Rs 14.9 trillion for 2012-13.
Of this, the plan expenditure is projected 22.13% higher at Rs 5.21 trillion.
Non-plan expenditure for 2012-13 is budgeted at Rs 9.69 trillion.

Measures for broadening tax base, strengthening compliance and simplification

- Rates and slabs are rationalized
- Negative list of services for taxation from 2012 at 12%
- adoption of VAT by almost all the states
- GST introduction
- Tax to be deducted at source on various items like interest on bank deposits; dividend distribution etc
- Quoting of permanent account number made compulsory for many transactions so more people can be brought into tax net
- securities transactions tax

Other measures suggested are: minimizing exemptions and concessions; drastic simplification of laws and procedures; building a proper information system and computerization of tax returns, and a thorough revamping and modernization of the administrative and enforcement machinery.



PROFILE OF CENTRE'S GROSS TAX RECEIPTS

(in Rs crore)

	1990-91	2000-01	2007-08	2008-09	2009-10 (BE)	2009-10 (RE)	2010-11 (BE)
DIRECT*	11024	68306	295938	319859	370000	380608	422500
Income	5371	31764	102644	106046	112850	125021	120566
Corporation	5335	35696	192911	213395	256725	255076	301331
INDIRECT	45158	118681	278945	269433	269477	244477	315000
Excise	24514	68526	123425	108613	106477	102000	132000
Customs	20644	47542	104119	99879	98000	84477	115000
Service	Nil	2613	51301	60941	65000	58000	68000
TOTAL**	57576	188603	593147	605298	640079	613095	746651
DIRECT %	19.15	36.22	49.89	52.84	57.72	60.12	56.59
TAX-GDP %	10.11	8.97	11.99	10.86	10.95	10.27	10.77

*Includes taxes on interest, expenditure, estate, gift and wealth;
**Includes 'other taxes & duties' and 'taxes of Union Territories';
BE: Budget Estimates; RE: Revised Estimates.

Tax collections 2012-13

As can be seen from the table above, Government of India's tax receipts were growing healthily. It helps government spend more on social projects.

The reasons for the tax collections being so healthy till recently

- economy is growing at a satisfactory pace- 6.5% in 2011-12
- incomes of individuals have gone up
- lower tax rates help compliance
- procedures are simple and citizen-friendly
- base has been widened
- a drive has been mounted to bring more people to pay income tax with proper investigation

Direct and Indirect Taxes in India: The Changing Scenario

As can be seen from table, direct tax collections are more than indirect tax collections. In 1990-91, less than a fifth of the Centre's gross tax revenues came from direct taxes.

The biggest taxation source of the Centre now is corporate tax and next is income tax.

The general level of prosperity in the country is increasing making more people have taxable incomes. Also, when companies are growing in number and also in their profitability, corporate tax collections increase. Global opportunities mean more profits. Stock market transactions and wealth build-up also contribute to direct tax collections by way of STT, capital gains tax, income tax. .Apart from the above reasons, the Government's measures as given below also helped increase the direct tax collections

- reduction of peak income tax rates that helps compliance
- reduction in the number of slabs
- strengthening the administration- e-governance etc
- simplification of laws(Saral etc)
- promote voluntary compliance

The increase in the relative share of direct tax collections shows that the tax system is becoming more progressive as direct taxes are paid by the well off in general while the indirect taxes are paid equally by all consumers. Direct taxes can be used to promote growth with equity.

Direct taxes help in income redistribution. Decline in the relative share of indirect taxes is also seen as good because it promotes the competitive nature of Indian economy-attracts investment.

By taxing earnings of individuals and corporates rather than production and trade, there is less stifling of economic activity and there is employment generation.
In developed countries, direct taxes contribute more to the tax collections.

Cost of direct tax collection

Buoyant economic growth along with higher tax compliance have led to a desirable decline in the cost of direct tax collections as a proportion of total direct tax collections: all-time low of 0.54 per cent in 2007-08.That is, the income-tax department spends 54 paise for every Rs 100 direct tax collected by it, which is among the lowest in the world. The income tax department has a tax base of 3.5 crore assesses..

Income-tax slabs and rates

10 per cent rate on a slab extending up to Rs 5 lakh. Likewise, the 20 per cent rate will now apply on income slabs beyond Rs 5 lakh and up to Rs 8 lakh. The maximum marginal rate of 30 per cent on an income slab of above Rs 8 lakh.

Service Tax

Service tax was first imposed in 1994. A new service tax regime, based on a negative list of exempted services, came into effect in July 2012.

With this, all services — except the 38 activities put on the negative list — came under the tax at the increased rate of 12 per cent, as announced in the Union budget 2012-13.

Till June 2012, service tax was being levied on 119 services based on a positive list. The switch-over to a negative list-based approach is aimed at aligning the indirect taxation system to the proposed Goods and Services Tax (GST) regime, which is sought to be introduced to unify the levies of the Centre and the States into a composite system.

With the services sector now accounting for 60 per cent of the gross domestic product, the Finance Ministry has set a target of Rs.1.24 lakh crore for service tax collection during 2012-13. This is significantly higher than the Rs.97,000 crore mopped up during the previous fiscal.

As per the negative list-based approach, services such as metered taxis, auto-rickshaws, transport of goods or passengers and transmission and distribution of electricity by distribution companies will not come under the service tax net.

Other important services exempted from the levy are solemn activities such as funeral, burial and transport of deceased. In the education sector, school and university courses, as also approved vocational studies, have been exempted.

Likewise, auxiliary educational services and renting of immovable property by educational institutions in respect of education will not be taxed. However, coaching classes and training institutions will be taxed.

Among the other services included in the negative list are those provided to government, local authorities or a government authority for repair and maintenance of an aircraft. Likewise, services provided by advocates to other advocates and business entities up to a turnover of Rs. 10 lakh in the preceding financial year will be exempt from the tax.

Services provided by way of public convenience, such as bathroom, washroom, urinals or toilets, are included in the negative list, just as services relating to work contracts for a scheme under the Jawaharlal Nehru National Rural Urban Renewal Mission or the Rajiv Awas Yojana.

The service sector has emerged as an important area of economic activity. Reasons for taxing services

- Its share in the country's Gross Domestic Product (GDP) has increased from about 28% in 1951, to 55% (2011).
- Taxing services is important to raise resources and increasing the tax-GDP ratio
- service providers should share the tax burden with others-industry - there should be horizontal equity that is all sectors of the economy should bear the tax burden equitably.
- as the share of industry in GDP decreases while that of services expands, the tax base shrinks unless services are taxed.
- failure to tax services distorts consumer choices, encouraging spending on services at the expense of goods and savings.
- as most of the services that are likely to become taxable are positively correlated with expenditure of high income households, subjecting them to taxation will improve equity.

Service Tax and Indian Constitution

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) amended Article 270 (made it divisible)and inserted in the Union List (List I) entry No. 92C — `taxes on services'.

The amendment to the Constitution places services tax formally under the Union List. This will pave the way for the Centre to levy and collect the tax.

The amendment becomes redundant with the introduction of GST in 2011 where the services will be jointly taxed by Centre and States.

The amendment did not come into effect as it has never been notified and thus services are still taxed on a residuary basis.

GST

Goods and Services Tax is a multi-point sales tax with set off for tax paid on purchases of inputs. There is no 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.

India introduced VAT at the state level in 2005. Before that, union excise duties were renamed Central Vat (Cenvat). But when states called their slaes tax Vat, centre reverted to the earlier name of excise duty. 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.

Cenvat in replacement of central excise duties came into effect earlier in the decade. VAT as a replacement for state sales tax was adopted from the beginning of the fiscal year 2005-2006.Cenvat has come back to being called union excise duty to prevent confusion.

Need for GST

In the Union Budget for the year 2006-2007, Finance Minister proposed that India should move towards national level Goods and Services Tax that should be shared between the Centre and the States. World over, goods and services are integrated and taxed as a comprehensive domestic indirect taxation system based on value addition. They attract the same rate of tax. That is the foundation of a GST. The basis of GST is value addition.

The goods and service tax (GST) is proposed to be a comprehensive indirect tax levy on manufacture and sale of goods as well as services at a national level. Integration of goods and services taxation would give India a world class tax system and improve tax collections.

It would end the long standing distortions of differential treatments of manufacturing and service sector. The introduction of goods and services tax will lead to the abolition of taxes such as octroi, Central sales tax, State level sales tax, entry tax, etc and eliminate the cascading effects tax on tax.

It is aimed at forging 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

GST: Q and A

The central and state governments moved closer to ushering in a nationwide goods and services tax on April 1, 2011, a reform intended to cut business costs and boost government revenue. The reform would eliminate multiple indirect taxes levied by states and the central government, leading to a reduction in the average tax burden on companies and a rise in the country's tax-to-GDP ratio.

HOW WILL THE GST WORK?

The GST is an indirect tax that would replace existing levies such as excise duty, service tax, and value-added tax (VAT).Both the states and the central government would impose the tax on almost all goods and services produced in India or imported. Exports would not be subject to GST. For the first two years of operation, the proposal is for two rates both at the federal and state levels, converging to a single rate in the third year. Producers would receive credits for tax paid earlier, which would eliminate multiple taxation on the same product or service. Direct taxes, such as income tax, corporate tax and capital gains tax would not be affected.

WHAT'S THE RATIONALE FOR THE GST?

Eliminating a multiplicity of existing indirect taxes would simplify the tax structure, broaden the tax base, and create a common market across states and centrally administered districts. Increased compliance and fewer exemptions to GST would lift India's federal tax-to-GDP ratio.

At the same time GST would lower the average tax burden for companies that now pay "cascading" taxes on top of taxes through the production process.

By lowering business costs it would boost economic growth and increase exports, proponents argue, and bring India in line with practices in many developed economies.

Reducing production costs would make exporters more competitive.

The GST may usher in the possibility of a collective gain for industry, trade, agriculture and common consumers as well as for the central government and the state governments for reasons cited above.

Black money and evasion will reduce as GST is transparent.

WHAT ARE THE PROPOSED GST RATES?

For the first year: 10 percent of CGST of Centre and 10% of SGST of states for goods and 6 percent each for essential items. 8% each for services. Thus, it is dual rate. Also, goods and services are taxed separately initially.

The higher rate would come down to 9 percent in the second year, and the two rates would converge at 8 percent in the third year.

ARE THERE EXEMPTIONS PROPOSED?
Yes. Goods deemed necessary or of basic importance would be taxed at a lower rate. The government will review the various lists of exempted goods to align them at the federal and state levels.

Alcohol, petroleum and electricity would not come under GST.

WILL THE STATES LOSE OUT?
GOI will compensate states for potential lost revenue and central government has assured states that if needed, it would increase a 50,000 crore -rupee ($10.6 billion) fund that the 13th Finance Commission recommended as an incentive for the states to buy into GST.

WHAT HAPPENS NEXT?
The legislation to make constitutional amendments needs to be finalised and the mechanism for administering the tax needs to be created. The government also needs to set up the technology infrastructure to manage the tax- TAGUP (see ahead)

WHAT IS THE REVENUE IMPACT?
The GST is initially intended to be revenue-neutral but is eventually expected to increase the tax collections due to more efficient collection, expanded base, transparency and increased compliance.

WHAT ABOUT THE ECONOMIC IMPACT?
Implementation of a comprehensive GST would lift India's economy of over $1 trillion by between 0.9 percent and 1.7 percent, according to a report by the New Delhi-based economic think tank the National Council of Applied Economic Research. Exports would rise by between 3.2 percent and 6.3 percent, while imports would increase 2.4 percent to 4.7 percent, the study found.

Constitutional Amendment for GST

Constitution (One Hundred and Fifteenth Amendment), Bill, 2011 (GST Bill)
Constitution (One Hundred and Fifteenth Amendment), Bill, 2011 (GST Bill) was introduced in the Parliament in the budget session in March 2011, deals with GST. The Bill seeks to introduce Goods and Services Tax (GST) and the GST Council. As per the existing structure of indirect taxation, the Parliament has the power to make laws on the manufacture of goods and the provision of services (Union List) while the State Legislatures have the power to make laws on the sale and purchase of goods within their respective states (State List). The Parliament has retained the exclusivity to make laws pertaining to sale of goods in the course of inter-state trade or commerce.

Definition of Goods and Services – Article 366

1. The above Article which defines 'Goods and Services Tax' to mean, any tax on supply of goods or services or both except taxes on the supply of petroleum products and alcohol

Seventh Schedule

- The Union Government has the exclusive power to levy excise duty on the manufacture or production of
- Petroleum Crude
- High Speed diesel
- Petrol
- Natural Gas
- Aviation Turbine Fuel
- Tobacco and Tobacco Products

The State Governments shall have the power to levy tax on the sale (other than in the course of inter-state trade or commerce) of petroleum crude, high speed diesel, petrol, natural gas, aviation turbine fuel and alcoholic liquor for human consumption.

Article 249

The Parliament has been vested with the power to make laws pertaining to GST on behalf of the state Legislature in circumstances of national interest. The power to make such laws would be pursuant to a resolution passed by the Council of States supported by not less than a two-thirds majority of the members present and voting.

Power of Parliament to make laws on subjects in State List in the case of Emergency – Article 250

The Parliament has been vested with the power to makes laws pertaining to GST on behalf of the State Legislature when there is a proclamation of Emergency.

GST Council – Article 279A

The President shall constitute a GST Council within sixty days from the Commencement of the GST Act.

Membership of the GST Council

The Union Finance Minster would be the Chairperson, the Union Minister of State for Revenue shall be one of the members, the Finance Minister or any other minister nominated by each State Government shall be the members of the GST Council.

The Members of the GST Council shall decide on the Vice-Chairperson of the GST Council for such period as decided by the members.

Functions of the GST Council

The GST Council while being guided by the need for a harmonized structure goods and services tax and for the development of a harmonised national market for goods and services shall make recommendations to the Union and the States on:

Taxes, cesses and surcharges levied by the Union and the States and local bodies which may be subsumed within the GST

- Exemptions from GST for such goods and services
- Threshold limit of turnover below which GST may be exempted
- The GST rates
- Any other matter relating to GST

Every decision of the GST Council taken at a meeting shall be with the consensus of all the members present at the meeting.

GST Dispute Settlement Authority – Article 279B

The Parliament, by law, will provide for the creation of a Goods and Services Tax Dispute Settlement Authority (DSA) which shall adjudicate any dispute or complaint referred to the DSA by the State Government or the Union Government arising out of deviation from any recommendation of the GST Council which results in the loss of revenue to the State Government of the Union Government or affects the harmonised structure of the GST. The DSA shall consist of three members namely, the Chairperson, who has been a Supreme Court Judge or the Chief Justice of a High Court, appointed by the President, recommended by the Chief Justice of India; the remaining members shall be persons who shall have expertise in the field of law, economics or public affairs appointed by the President recommended by the GST Council.

The DSA shall pass suitable orders including interim orders only the Supreme Court shall exercise jurisdiction over such adjudication or dispute or complaint.

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
- 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. However, in case..... (in the classroom)

Contentious federal issues on GST

GST rates, the division of taxing powers between the Centre and the states, compensation amount; exemptions and on certain design elements of the GST.

Goods and Services Tax (GST): Challenges for implementation

The GST is a necessary condition for a common market to exists, this permits free and unimpeded movement of goods and services across a federation, thus encouraging efficient regional specialization.

Such harmonization will significantly reduce the vertical imbalance between the Centre and the states by enhancing the tax base of the states. It is going to be the biggest ever tax reform in India.

Challenges to address:

- Integration of a large number of Central & State Taxes
- multiplicity of taxes and tax rates to be unified
- federal distribution of powers to levy and collect taxes
- necessary constitutional amendments.
- Rationalisation of thresholds and exemption limits.
- Standardisation of systems and procedures.
- road based computerizations across the Nation.
- Dispute settlement procedure and machinery.
- Training of tax administrators and assessee.
- Protecting and balancing the present and future revenues of the Centre and the States.
- Safeguarding the interests of less developed States with lower revenue potential.
- Taxing of Alcohol, tobacco, petroleum products which are out of the GST regime.

GST and fiscal federalism

Being the largest indirect tax reform requiring the centre and the states to adjust their constitutional taxing powers, GST has opened up fiscal federal challenges like never before. There is mutual surrender of powers to a uniform national taxation system where both gain. But there are apprehensions of loss of fiscal autonomy by states and central dominance as mentioned above.

The Constitutional changes proposed and being debated by the Empowered Committee of State Finance Ministers are likely to bring the federal units together for a new and innovative system of fiscal federal sharing and cooperation.

Technology Advisory Group for Unique Projects (TAGUP)

An effective tax administration and financial governance system calls for creation of IT projects which are reliable, secure and efficient. IT projects like Tax Information Network, New Pension Scheme, National Treasury Management Agency, Expenditure Information Network, Goods and Service Tax, are in different stages of roll out. To look into various technological and systemic issues, Finance Minister announced in the Union Budget 2010-11 to set up a Technology Advisory Group for Unique Projects under the Chairmanship of Shri Nandan Nilekani. It has been set up in mid-2010.

GST and tax efficiency

In the system existing now, the rates, tax imposition and collection are inefficient. Rates are not efficient as they depend on lobbying and there is no transparent basis. Exemptions are also similarly granted. Thus, deployment of labour and land along with capital and enterprise becomes subject to lower returns and waste- GST is expected to lead to efficient allocation of factors of production thus leading to gains in GDP and exports. This would translate into enhanced economic welfare and returns to the factors of production, viz. land, labour and capital. In an earlier taxation system, people paid taxes at various levels. There was no system of getting a rebate on the taxes paid previously while paying the inputs. This is also called as cascading effect. It is irrational as there is tax on tax. Ideally the taxes should be based on value addition and the producer should pay taxes on whatever value he adds to the product. In the absence of such a system, producers ended up paying much higher taxes. Higher taxes are a barrier for business and discourage business activity.

High taxes also lead to lobbying activities where producers of a certain sector ask the government to lower/waiver taxes for their sector. This also leads to multiple taxation rates for multiple products and further increases inefficiency in the system.

Before VAT States had sales taxes with multiple rates. States were often seen in a sales tax war with other states- rate war as it is called . In the war states competed with each other offering lower tax rates to certain industries to set units in their states. This resulted in revenue loss for both the states and investment decisions wre determined by tax rates in states and not other merit factors.

However, the design of VAT system in each state has also been done in a uniform fashion keeping the distinctive state economy in mind.

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
- investment flows

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

- Reduction and rationalization of rates- there are only three rates of income tax today with the highest rate at 30%
- Simplification of procedures
- Strengthening of administration
- Widening of the tax base to include more tax payers in the tax net
- Exemptions are gradually being withdrawn.
- MAT was introduced for the 'zero tax' companies
- The Direct Tax Code of 2010 is meant to replace the outdated Income Tax Code of 1961

Indirect Taxes

- Reduction in the peak tariff rates- 10% is the peak customs duty today which was more than a 90% reduction since 1991.
- The number of slabs has come down drastically
- There is a progressive change from specific duty to ad valorem tax
- VAT is introduced
- GST is being rolled out
- Negative list of service tax from 2012

Tax expenditure

Tax expenditure refers to revenue forgone as a result of exemptions and concessions (personal, corporate, indirect tax). It was introduced for the first time in 2006-07 Union Budget. The revenue foregone due to tax incentives in 2009-10 is estimated at Rs 5,40,269 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. These 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 nmore 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.

Tax havens and G20

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. Different jurisdictions tend to be havens for different types of taxes, and for different categories of people and/or companies. For example, income tax, wealth tax or corporate tax etc.

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
- self-promotion as an offshore financial center.

Switzerland, 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 their banking secrecy. Among the sanctions being considered by the G20 are the scrapping of tax treaty arrangements, imposing additional taxes on companies that operate in non-compliant countries and tougher disclosure requirements for individuals and businesses that use shelters.

Words

Tax-incidence: It shows the entity on whom tax is imposed. It is different from the tax burden as shown below: if government increases tax on petrol, oil companies may absorb it if competition is intense or they may pass it on to private motorists. Tax incidence here refers is on companies and the burden may be on the consumer.

Tax Burden: It means those who actually pay taxes- from whom tax is collected. Depending on the market forces involved, a tax can be absorbed by the seller or by the buyer (in the form of higher prices), or by a third party like sellers' employees in the form of lower wages.

Tax Base: The value of goods, services and incomes on which tax is imposed. When economists 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 rate: It indicates how much tax is due from each source. Some tax systems have high rates but have a narrow base allowing generous deduction of business expenses. Other tax systems have a wide base with few exemptions and lower rates.

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.

Difference between tax 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 the benefit, it is called tax avoidance. It is lawful to take all available tax deductions.

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

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.

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 will send financial aid to a person who files an income tax return reporting an income below a certain level.

Pigovian tax
The Pigovian tax is imposed on bodies 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. Example of negative externality is 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. Carbon tax is one example in the context of the need to discourage fossil fuels and encourage renewable sources due to climate change threat.

Octroi: Entry 52 of the State List, VII Schedule, which specifies tax on the entry of goods into a local area is the octroi. Octroi has been a main source of revenue for most of the urban local bodies in India. It is criticized for the fact that it is an obsolete method of tax collection; and involves stoppage of vehicles at the check posts outside the city limits, thereby obstructing a free flow of vehicular traffic; waste of business hours; loss of fuel etc.

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.

Tobin tax

James Tobin, an economist, proposed 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 attributed to the 'dynamics of hot money'(portfolio investments or FII flows).

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 a 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. Angele Merkel and Francois Hollande both want it.

India and FTT

Group of 20 saw the European countries like Germany and France propose a tax on their transactions so that fund could be mobilised in order to bail out future bank failures. The idea is to avoid taxing ordinary people. India along with Brazil and other countries opposed it on the following grounds

- Regulation is the remedy
- Banks can pay the tax and not shed their reckless behavior
- It may in fact induce them to be more reckless as there is a ready fund available and bailout is guaranteed
- India has a well regulated banking system and so did not suffer the same fate as the banks in developed economies. The problems of the advanced countries should not be imposed on others
- banks, as private entities, would simply push the added costs onto consumers.

India has a similar tax though not for the same purpose- securities transaction tax (STT)

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% (2012).

Book profit is Profit which is notional made but not yet realized through a transaction, such as a stock which has risen in value but is still being held. It is also called unrealized gain or unrealized profit or paper gain or paper profit.

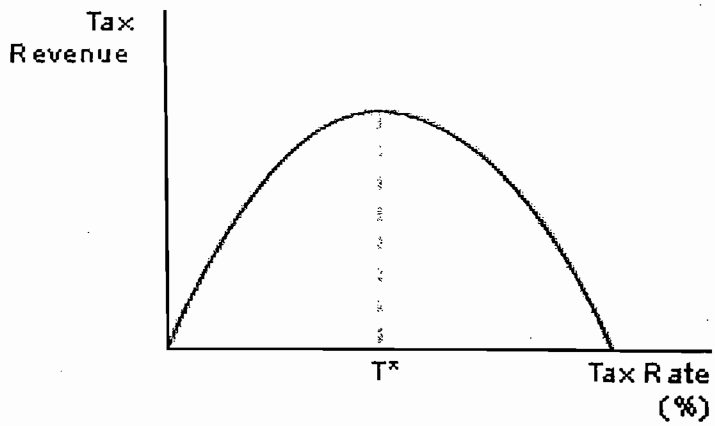
Presumptive Tax

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 differ from the usual rules based on the taxpayer's accounts. The term presumptive is used to indicate that there is a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method.

The reason for the presumptive tax is 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.

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.

Inverted duty structure
Higher import duty on the raw materials than on the finished product are called inverted duty structure .It puts the domestic manufacturers at a disadvantage making them uncompetitive. For instance, compact fluorescent lamps (CFLs), where the import duty on raw materials for manufacturing CFLs is 9.7 per cent more than on finished bulbs. This skewed duty structure makes domestic CFL manufacturers uncompetitive.

There is no Basic Customs Duty for import of solar cells and modules. However, under the existing duty structure, the inputs (like EVA, Tedlar, Toughened Glass) which go into the manufacturing of solar cells and modules attract duty .This results in an inverted duty structure, which favours the import of the cells / modules and puts the domestic manufacturers to a disadvantage.

Similarly, if rubber is imported at a higher duty than tyre, manufacturing in India is discouraged.

The Economic Survey (2010-11) said FTAs also lead to a new type of inverted duty structure with duties for final products being lower from FTA partners compared to duties for the previous-stage 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," the Survey said.

Import duty on raw silk is more than silk fabric (2013 December)

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. 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. For short term capital gains (less than one year), it is 15% for shares.

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.

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.

Transfer Pricing

Transfer pricing involves charging for goods supplied to the subsidiary. The international norm in this regard is the `arms length principle' which means that when two related parties deal in goods and services, pricing must be done objectively and commercially. If the principle is not followed, it means losses for the government. For example, an MNC has a subsidiary in India and elsewhere. The corporate tax rates are high in India. Therefore, the price of goods sold by the MNC to the two subsidiaries in the two countries is shown differently- higher in India and less in the other country. In that case, Indian subsidiary shows less profits or more losses and tax liability (corporate tax) is less.

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 introduction of Advance Pricing Agreement (APA) under Transfer Pricing Regulations in the union budget of year 2012 -13 is positive step to reduce the litigation as it will be based on bilateral understanding between two countries.

According to the memorandum of union budget, Advance Pricing Agreement is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future. The APAs offer better assurance on transfer pricing methods and are conducive in providing certainty and unanimity of approach.

Death tax (in the class)

Rupee is raised and spent like this

For every rupee in government kitty, 29 paise will come from market borrowing in 2012-13.

The government's dependence on debt has gone up from 27 paise in the previous Budget to 29 paise in the coming year, reflecting the pressure on revenue collections.

The net borrowings of the government in 2012-13 are pegged at Rs 4.79 lakh crore against Rs 4.36 lakh crore for the current fiscal.

On the expenditure side, central Plan will account for an outgo of 22 paise, followed by 18 paise of interest payments.

Defence allocation has been maintained at 11 paise. As the single largest source of revenue income, the collection from corporate tax has decreased to 21 paise to 24 paise as a per centage of every rupee earned, indicating the sluggish growth in the industry.

However, with increase in the service tax rate, the government expects revenue collection from service tax and others to go up to 7 paise against 6 paise in 2011-12.

Besides, other indirect tax component excise and customs would earn 21 paise for the government.

Despite tax incentives given to individuals, direct tax contribution has been retained at 9 paise.

With rising crude oil price due to global economic uncertainty, the subsidy burden on the government would go up 10 paisa against 9 paise for the year ending March 2012.

At the same time, other non-plan expenditure is expected to account for 11 paise of every rupee spent by the government in 2012-13, while the states' share of taxes and duties would amount to 17 paise of every rupee earned.

Plan assistance to states and Union Territories has been retained at 7 paise in 2012-13. (Figures to be revised after the General Budget is presented in June 2014).