21UCR405 - INDIRECT TAX

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TEXT BOOK FOR REFERENCE

1. V.Balachandran, "Indirect Taxation", Sultan Chand & Sons, New Delhi, *.2016 edition*
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UNIT-1

INTRODUCTION TO TAX

INTRODUCTION TO TAX

Taxation is the means by which a government or the taxing authority imposes or levies a tax on its citizens and business entities. From income tax to goods and services tax (GST), taxation applies to all levels.

WHAT IS TAXATION

The Central and State government plays a significant role in determining the taxes in India. To streamline the process of taxation and ensure transparency in the country, the state and central governments have undertaken various policy reforms over the last few years. One such change was the Goods and Services Tax (GST) which eased the tax regime on the sale and deliverance of goods and services in the country.

The tax structure in India can be classified into two main categories:

- Direct Tax
- Indirect Tax

Direct Tax: It is defined as the tax imposed directly on a taxpayer and is required to be paid to the government. Also, an individual cannot pass or assign another person to pay the taxes on his behalf.

Some of the direct taxes imposed on an Indian taxpayer are:

1. **Income tax**- it is the tax applicable on the income earned by an individual or taxpayer.
2. **Corporate tax**- this is the tax applicable on the profits earned by companies from their businesses.

Indirect Tax: It is defined as the tax levied not on the income, profit or revenue but the goods and services rendered by the taxpayer. Unlike direct taxes, indirect taxes can be shifted from one individual to another. Earlier, the list of indirect taxes imposed on taxpayers included service tax, sales tax, value added tax (VAT), central excise duty and customs duty.

However, with the implementation of goods and services tax (GST) regime from 01 July 2017, it has replaced all forms of indirect tax imposed on goods and services by the state and central governments.

GST has not only been reduced the physical interface but also lower the cost of compliance with the unification of the indirect taxes.

Canons of Taxation and Equity in Taxation!

Meaning of Canons of Taxation:

Canons of taxation refer to the administrative aspects of a tax. They relate to the rate, amount, method of levy and collection of a tax.

In other words, the characteristics or qualities which a good tax should possess are described as canons of taxation. It must be noted that canons refer to the qualities of an isolated tax and not to the tax system as a whole. A good tax system should have a proper combination of all kinds of taxes having different canons.

Canon of Equality:

Every fiscal economist, along with Adam Smith, stresses that taxation must ensure justice. The canon of equality or equity implies that the burden of taxation must be distributed equally or equitably in relation to the ability of the tax payers.

Equity or social justice demands that the rich people should bear a heavier burden of tax and the poor a lesser burden. Hence, a tax system should contain progressive tax rates based on the tax-payer's ability to pay and sacrifice.

Canon of Certainty:

Taxation must have an element of certainty. According to Adam Smith, "the tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the amount to be paid ought to be clear and plain to the contributor and to every other person."

Canon of Economy:

This principle suggests that the cost of collecting a tax should not be exorbitant but be the minimum. Extravagant tax collection machinery is not justified. According to Adam Smith, "Every tax has to be contrived as both to take and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state."

Canon of Convenience:

According to this canon, tax should be collected in a convenient manner from the tax payers. Adam Smith stresses: "Every tax ought to be levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it." For example, it is

convenient to pay a tax when it is deducted at source from the salaried classes at the time of paying salaries.

Canon of Elasticity:

Taxation should be elastic in nature in the sense that more revenue is automatically fetched when income of the people rises. This means that taxation must have built-in flexibility.

Canon of Productivity:

This implies that a tax must yield sufficient revenue and not adversely affect production in the economy.

Canon of Simplicity:

This norm suggests that tax rates and tax systems ought to be simple and comprehensible and not to be complex and beyond the understanding of the layman. This is what is rarely found in the Indian tax structure.

Canon of Diversity:

Canon of diversity implies that there should be a multiple tax system of diverse nature rather than having a single tax system. In the former case, the tax payer will not be burdened with a high incidence of tax in the aggregate.

OBJECTIVES OF TAXATION:

The primary purpose of taxation is to raise revenue to meet huge public expenditure. Most governmental activities must be financed by taxation. But it is not the only goal. In other words, taxation policy has some non-revenue objectives.

Objective # 1. Economic Development:

One of the important objectives of taxation is economic development. Economic development of any country is largely conditioned by the growth of capital formation. It is said that capital formation is the kingpin of economic development. But LDCs usually suffer from the shortage of capital.

To overcome the scarcity of capital, governments of these countries mobilize resources so that a rapid capital accumulation takes place. To step up both public and private investment, government taps tax revenues. Through proper tax planning, the ratio of savings to national income can be raised.

By raising the existing rate of taxes or by imposing new taxes, the process of capital formation can be made smooth. One of the important elements of economic development is the raising of savings- income ratio which can be effectively raised through taxation policy.

However, proper care has to be taken, regarding investment. If financial resources or investments are channelized in the unproductive sectors of the economy the economic development may be jeopardized, even if savings and investment rates are increased. Thus, the tax policy has to be employed in such a way that investment occurs in the productive sectors of the economy, including the infrastructural sectors.

Objective # 2. Full Employment:

Second objective is the full employment. Since the level of employment depends on effective demand, a country desirous of achieving the goal of full employment must cut down the rate of taxes. Consequently, disposable income will rise and, hence, demand for goods and services will rise. Increased demand will stimulate investment leading to a rise in income and employment through the multiplier mechanism.

Objective # 3. Price Stability:

Thirdly, taxation can be used to ensure price stability—a short run objective of taxation. Taxes are regarded as an effective means of controlling inflation. By raising the rate of direct taxes, private spending can be controlled. Naturally, the pressure on the commodity market is reduced.

But indirect taxes imposed on commodities fuel inflationary tendencies. High commodity prices, on the one hand, discourage consumption and, on the other hand, encourage saving. Opposite effect will occur when taxes are lowered down during deflation.

Objective # 4. Control of Cyclical Fluctuations:

Fourthly, control of cyclical fluctuations—periods of boom and depression—is considered to be another objective of taxation. During depression, taxes are lowered down while during boom taxes are increased so that cyclical fluctuations are tamed.

Objective # 5. Reduction of BOP Difficulties:

Fifthly, taxes like custom duties are also used to control imports of certain goods with the objective of reducing the intensity of balance of payments difficulties and encouraging domestic production of import substitutes.

Objective # 6. Non-Revenue Objective:

Finally, another extra-revenue or non-revenue objective of taxation is the reduction of inequalities in income and wealth. This can be done by taxing the rich at higher rate than the poor or by introducing a system of progressive taxation.

DIFFERENCE BETWEEN TAX vs DUTY

Parameters of Comparison	Taxes	Duties
Definition	A certain amount levied on citizens on wealth, income, services, or sales is called taxes.	A certain amount levied on commodities that are imported or exported are called duties.
Introduced by	Sir James Wilson	Constitution of India (in India)
Introduced in	1860	1962 (in India)
Objective of the Government	To increase remuneration to meet society's expenses.	Safeguard domestic industry
Sub-categories	Direct tax, Indirect tax, Progressive tax, Regressive tax, Proportionate tax	Excuse Duties and Custom Duties Basic custom duties, Countervailing duty, Additional customs duty or Special duty, Safeguard duty, National Calamity Contingent duty, Anti-dumping duty, Education cess on customs duty, Protective duties.

MAIN DIFFERENCE BETWEEN TAX vs DUTY

1. **Taxes** are charged on services, sales, income etc., on the other hand, customs **duties** are charges on commodities that are exported and imported globally.
2. **Taxes** have sub-categories such as direct tax, indirect tax, progressive tax, regressive tax, proportionate tax. On the other hand, **duties** have sub-categories such as Excise Duties and Customs Duties and customs duties is further classified into various types.
3. **Taxes** are charged by either State Government or Central Government. On the contrary, **duties** are charged by only the Central Government.
4. The **tax** itself is an independent term. On the contrary, customs duty is a type of tax.

5. The term **“tax”** was derived from the Latin word “taxare” on the contrary. The term **“duties”** was derived from an Anglo-French word “deueté”.

MERITS OF INDIRECT TAX:

Indirect taxes have the following advantages:

(a) Convenience:

Indirect taxes are less inconvenient and burdensome to the taxpayer than the direct taxes. Since taxes are included in the price of the taxed commodity the taxpayer does not feel the burden of the taxes. It is convenient also because these taxes are not paid in lump-sum amount unlike direct taxes. Sometimes, the consumer may not be aware of the fact that he pays tax. Above all, an indirect tax can be avoided by not buying taxed commodities. But, once a taxpayer crosses the threshold limit, he or she will have to pay direct taxes. For all these reasons, indirect taxes are both convenient and burden-free.

(b) Broad-Based:

Indirect taxes are broad- based since the effects are felt by more or less all the people in the community. Direct tax, on the other hand, has a narrow base. The lower income group is not required to pay income tax but he cannot escape the indirect tax net once he purchases a tax-imposed commodity.

(c) Elastic and Productive:

Elasticity and productivity are the other merits of indirect tax. It is flexible or elastic in the sense that it can be revised in accordance with the requirements of the government. It is also revenue-yielding since its bases are wide.

(d) Difficulty in Evading Taxes:

It is difficult to evade indirect tax since such tax is included in the price of the commodity even if the rate of tax is high.

(e) Social Objective:

Indirect taxes are often levied on harmful and luxury goods whose consumption has to be curtailed so as promote social welfare. Thus, an indirect tax has a social purpose.

(f) Important Anti-Inflationary Measure too:

It is said that indirect taxes, as contrasted to direct taxes, are more effective in controlling inflation. Truly speaking, indirect taxes may fuel inflationary pressure in the economy.

DEMERITS OF INDIRECT TAX:

Its disadvantages are equally significant:

(a) Regressive in Character:

As these taxes fail to satisfy the principle of distributive justice, it is considered to be a regressive tax.

Principle of progressiveness is violated since the burden of an indirect tax falls upon all persons indiscriminately, irrespective of their ability to pay. As these taxes are not levied in accordance with the principle of ability to pay, burden of taxes mostly falls upon the poorer persons. Thus, these taxes are unjust and inequitable.

(b) Uncertain Revenue Earning:

It fails to satisfy the Smithian canon of certainty because the revenue accruing from indirect taxes cannot be estimated properly. As soon as a tax on a commodity is imposed its price rises. The law of demand states that there will be a fall in quantity demanded following this price rise.

How much the demand will fall consequent upon the imposition of taxes cannot be estimated accurately. So is the revenue-yielding capacity of taxes. Thus, an element of uncertainty is involved in indirect taxes.

(c) Unproductive:

It is uneconomical since the cost of collecting indirect taxes is rather high. In this sense, some of the indirect taxes are unproductive.

(d) Civic Consciousness not Created:

These taxes do not create civic consciousness as its burden is not clearly felt by the taxpayers. They lack interest in making a vigil on government expenditure. However, this is not true, particularly when the rate of indirect taxes becomes high. Excessive dose of taxation often leads to public protest against the government’s taxation policies.

(e) Possibility of Evasion:

Indirect taxes are also evaded by taxpayers. Development of an unholy alliance between buyers and sellers may result in tax evasion. Usually, buyers evade taxes by not accepting **‘receipts of sale’** from the sellers. Sellers also evade these taxes by not maintaining legal accounts book.

(f) Wage-Price Push:

Finally, instead of being an anti-inflationary device, increased rates of indirect taxes have the potentiality of fuelling cost-push inflationary pressures in the economy. Higher prices

consequent upon high rate of tax result in higher costs, higher wages, and again higher prices. A wage-price spiral is thus initiated.

TYPES OF INDIRECT TAXES

1. **Goods and Services Tax**:

The law on GST was brought to action in July 2017, with 17 indirect taxes under its purview. All major services and service tax has been subsumed under the GST-

On the state level:

- State excise duty
- Additional excise duty
- Service tax
- Countervailing duty
- Special additional custom duties

At the central level, it covers:

- Sales Tax
- Entertainment Tax
- Central sales Tax
- Octroi and entry Tax
- Purchase Tax
- Luxury Tax
- Taxes on lottery gambling and betting
- Levies on products outside GST purview:

Taxes on products that use alcohol and petroleum products.

2. **Sales Tax**:

The tax levied on the sales of goods. The Union Government imposes this sales tax on the Inter-State sale, while the sale tax on Intra-state sale is levied by the State Government. This tax has a three-segment bifurcation along

- Inter-State Sale
- Sale during import/export
- Intra-State Sale

3. **Service Tax**:

Service tax are indirect indices which taxpayers pay on various paid services. These paid services include-

- Telephone

- Tour operator
- Architect
- Interior decorator
- Advertising
- Health centre
- Banking and financial service
- Event management
- Maintenance service
- Consultancy service
- Service tax interest is 15%

4. **Value Added Tax**:

The state governments collect this category of taxes. For instance, when a person buys a product that it is important, we pay an additional tax known as Value Added Tax. Paid to the government, the VAT has a rate that is composed along nature of item and respective state of sale.

5. **Custom Duty and Octroi Tax**:

Levied upon goods imported into the country from abroad. The tax of custom duty is paid at the entry port of a country such as the airport. The rate of taxation is variable as per product's nature. Octroi is charged upon the goods entering a municipal zone.

6. **Excise Duty**:

Excise duty is an indirect tax form that is charged on the goods produced inside a country. This duty is different from the custom duty. This is also known as CVAT, or Central Value Added Tax.

7. **Anti-Dumping Duty**:

This is levied upon goods that are exported at a rate less than the standard rate by the nation to some other nation. This tax is levied upon by the Central government.

BENEFITS OF INDIRECT TAX

- **Poor Contributes Too-** It is essential for the country that every individual contributes towards its development. As the poor are often exempt from paying direct taxes, the indirect taxes ensure that even poor contribute towards nation-building.
- **Convenience-** Unlike direct taxes which are generally paid in a lump-sum, indirect taxes like GST are paid in small amounts. When you purchase a product or service, a small amount of GST is already included in the price, and this makes its payment more convenient for the taxpayers.

- **The collection is Easy-** If you want to know **what is the difference between direct and indirect tax**, one of the biggest of them is how they are paid. Unlike direct taxes, there are no documents or complex procedures involved in paying indirect taxes. You are required to pay the tax right when you purchase a product or service.

DIFFERENCE BETWEEN DIRECT TAX vs INDIRECT TAX

Context	Direct Tax	Indirect Tax
1. Imposed on	Income and profits	All the goods and services
2. Who pays	Individuals and businesses	End-consumers
3. How much	Depends on income and profits	Same for everyone
4. Transferability	Not transferable	Transferable
5. Tax Evasion	Possible	Not possible
6. Nature	Progressive	Regressive
7. Collections	Complex	Convenient
8. Common examples	Income tax and securities transaction tax	GST, excise duty, and VAT

DEFINE ASSESSEE

An Assessee is any individual who is liable to pay taxes to the government against any kind of income earned or any losses incurred by him for a particular assessment year. Each and every person who has been taxed in the previous years for income earned by him is treated as an Assessee under the Income Tax Act, 1961.

TYPES OF ASSESSEE

1. **Normal Assessee:**

A normal Assessee is an individual who is liable to pay taxes for the income earned by him for a particular financial year. Each Individual who has paid taxes in preceding years against the income earned or losses incurred by him is liable to make payments to the government in the form of tax.

2. **Representative Assessee:**

Many times, it so happens that an individual is liable to pay taxes for income or losses incurred not only by him, but also for income or losses incurred by a third party. Such an individual is known as Representative Assessee. Basically, he acts as a representative for people who

themselves are not able to file and pay their taxes themselves. Generally, the people who need representatives are non-residents, minors, or lunatics.

3. **Deemed Assessee:**

Deemed Assessee is an individual who is put in a position to pay taxes for some other person by the legal authorities.

4.Assessee-in-default:

An Assessee-in-default is an individual who has failed to fulfil his legal duty of paying tax to the government. An employer is deemed to be an Assessee in default if he fails to submit the TDS deducted by him to the government. An employer is supposed to disburse salary to his employees after deducting TDS from their salary and submit the same to the government. However, if he fails to do so then he is treated as an Assessee-in-default.

ASSESSMENT YEAR AND PREVIOUS YEAR

Previous Year Meaning - Previous Year is the financial year, in which the assessee earns income.

Assessment Year - Assessment Year is the financial year, in which the income of the assessee earned during the previous year is evaluated and taxed

Assessment Year & Previous Year

Assessment Year	Previous Year
Defined u/s 2(9)	Defined u/s 3
It means a period of 12 months commencing on 1st April every year.	It means the financial year immediately preceding the assessment year. It always ended on 31st March every year, except for undisclosed sources of income.
It is mostly a duration of 12 months	It may have a duration of less than 12 months or even more than 12 months as the case may be.
This is a year which assess the income which is earned in Previous Year.	This is a year in which income is earned by person.
For the current examination the Assessment Year (A.Y.) is 2020-21	For the current examination the Previous Year (P.Y.) is 2019-20

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