unit - I

TAX

A tax is "*a compulsory charge imposed by the Government without any expectation of direct return in benefit*".

In other words, a tax is a compulsory payment or contribution by the people to the Government for which there is no direct return to the tax payers. Tax imposes a personal obligation on the people to pay the tax if they are liable to pay it. The general public should be taxed according to their ability to pay, and the people in the same financial position should be taxed in the same way without any discrimination.

A good tax system should not affect the ability and willingness of the people to work, save and invest. If not, it will affect the development of trade and industry and the economy as a whole. Thus, a sound tax system should contribute in the economic development of a country.

Hence, " *Taxation should not be like killing the goose that lays golden eggs* ".

General Characteristics of Tax

A tax has the following characteristics :

1. Tax is a Compulsory Contribution : Tax is a compulsory contribution by the tax payers to the Government. The people whom the tax is levied cannot refuse to pay the tax. Once it is levied, they have to pay it. Any refusal in this regard leads to punishments.

2. Benefit is not the Basic Condition : For the payment of tax, there is no direct return or quid proquo to the tax payers. That is, people cannot expect any return in benefit for the amount of tax paid by them. Because there is no relation between the amount of tax paid by the people and services rendered by the Government to the tax payers.

3. Personal Obligation : Tax imposes a personal obligation on the tax payers. When a person becomes liable to pay the tax, it is the duty of him to pay it and in no way he can escape from it.

4. Common Interest : The amount of tax received from the people is used for the general and common benefit of the people as a whole. Now the Government has to render enormous range of social activities which incur heavy expenditure. A part of the expense is sought to be raised through taxation of various types. Thus, taxes are said to be the sharing of common burden by the people.

5. Legal Collection : Tax is the Legal collection. It can be levied only by the Government both Central and State.

6. Element of Sacrifice : Since the tax is paid without any return in benefit, it can be said that there is the prevalence of sacrifice in the payment of tax.

7. Regular and Periodical Payment : The payment of tax is regular and periodical in nature. It is levied for a fixed period usually a year. Thus, almost all the taxes are annual taxes. The payment of taxes should be regular also.

8. No Discrimination : Tax is levied on all people without any discrimination of caste, creed, etc., but according to their ability to pay.

9. Wide Scope : Tax is levied not only on income but also on property and commodities. To enhance the revenue and to bring all the people under the tax net, the Government imposes various kinds of taxes. This enhances the scope of taxes.

Objectives of Taxation

Taxes are compulsory payments to the Government by the tax payers. In the beginning, Government imposed taxes for three basic purposes viz., to cover the cost of administration, maintaining law and order in the country and for defence.

But, in modern days, there has been a sea change in the Government's expenditure pattern. Today, the Government is in the position to restore social justice in the society by way of providing various social services like education, employment, pension, public health, housing, sanitation and the development of weaker sections of the society. Besides the above, the Government announces heavy subsidies for agriculture and industry. For example, subsidies to fertilizing industries. Thus, Government requires more amount of revenue than before. Non-tax revenues are not sufficient to meet the entire expenditures. Hence, Government imposes taxes of various types.

Let us discuss the objectives of taxation hereunder :

1. Raising Revenue : The basic purpose of taxation is raising revenue. To render various economic and social activities, Government requires large amount of revenue. To meet this enormous expenditure, Government imposes various types of taxes in addition to the non-tax revenue.

2. Removal of Inequalities in Income and Wealth : The welfare state aims at the removal of inequalities in income and wealth. By framing suitable tax policy, this end can be achieved. It is stressed in the canon of equality. In India, the progressive taxation on income and wealth and heavier excise and customs duties, taxes on luxurious goods are the suitable examples in this regard.

3. Ensuring Economic Stability : Taxation affects the general level of consumption and production. Hence, it can be used as an effective tool for achieving economic stability. That is, by means of taxation the effects of trade cycle i.e., inflation and deflation can be controlled. During the period of boom or inflation, the excess purchasing power in the hands of people leads to raise in the price level. Such excess purchasing power can be removed by raising the existing tax rates or imposing additional taxes. Then the abnormal demand will be reduced and the economic stability can be achieved. At the same time, by providing grants, tax exemptions and concessions, production can be encouraged, there by inflation is controlled.

Likewise, during the period of depression or deflation, the role of tax policy in the economy is important. Reduction in the existing tax rates and removal of certain taxes, consumption can be induced which in turn results in increasing demand. This encourages business activities, and the economic growth can be achieved.

Thus, through properly devised tax system, the economic stability can be achieved by controlling the effects of trade cycle.

4. Reduction in Regional Imbalances : It is normal that certain parts of the country are well developed, whereas some other parts or states are in backward conditions. To remove this regional imbalances, the Government can use tax measures. By way of announcing various tax exemptions and concessions to that particular backward regions or states, the economic activities in those areas can be induced and accelerated.

5. Capital Accumulation : Tax concessions or rebates given for savings or investment in provident funds, life insurance, unit trusts, housing banks, post offices banks, investment in shares and debentures of certain companies, etc., leads to large amount of capital accumulation which is essential for the promotion of industrial development.

6. Creation of Employment Opportunities : More employment opportunities can be created by giving tax concessions or exemptions to small entrepreneurs and to the industries adopting labour-intensive-techniques. In this way, unemployment problem can be solved to certain extent.

7. Preventing Harmful Consumption : Taxation can be used to prevent harmful consumption. By way of imposing heavy excise duties on the commodities like liquors, cigars, etc., the consumption of such articles is reduced to a considerable extent.

8. Beneficial Diversion of Resources : The imposition of heavy duties on non-essential and luxury goods discourages the producers of such goods. The resources utilised for the production of these goods may be diverted into the production of other essential goods for which various tax concessions are given. This is called as beneficial diversion.

9. Encouragement of Exports : Now-a-days export oriented industries are encouraged by way of providing various exemptions like

100% relief from income tax, free trade zones, etc. It results in the large earnings of foreign exchanges.

10. Enhancement of Standard of Living : By way of giving various tax concession to certain essential goods, the Government enhances the standard of living of people.

Canons of Taxation

The Government requires funds for the performance of its various functions. These funds are raised through tax and non-tax sources of revenue. Tax revenues are raised by imposing tax on income, property and commodities, etc. In fact, tax is the major source of revenue to the Government. According to **Adam Smith**, " *A tax is a contribution from citizens for the support of the Government* ".

Taxation is an important instrument for the development of economy of the country. A good tax system ensures maximum social advantage without any hardship on tax payers. While framing the tax policy, the Government should consider not only its financial needs but also taxable capacity of the community. Besides the above, Government has to consider some other principles like equality, simplicity, convenience, etc. Many economists have suggested various principle regarding taxation. These principles are called as " **Canons of Taxation** ". The following are the important canons of taxation.

Adam Smith in his book, " **Wealth of Nations** " has explained the following four canons of taxation which are accepted by all as good taxation policy. They are :

1. Canon of equality
2. Canon of certainty
3. Canon of convenience
4. Canon of economy

Canons given by others

5. Canon of productivity
6. Canon of elasticity
7. Canon of diversity
8. Canon of simplicity
9. Canon of expediency
10. Canon of co-ordination
11. Canon of neutrality

1. Canon of Equality : According to this principle of **Adam Smith**, *"the subjects of every state ought to contribute towards the support of the Government, as nearly as possible, in proportion to their abilities "*. That is, a good tax system should be based on the ability to pay of the people. That is, all people should bear the public expenditure in proportion to respective abilities. Tax burden should be more on the rich than on the poor. Since the rich people can pay more for public welfare, more tax should be collected from richer section and less tax from the poor. The ability to pay may be determined either on the basis of income and wealth or on the basis of consumption i.e., luxury or necessity.

2. Canon of Certainty : Another important canon of taxation advocated by **Adam Smith** is certainty. According to him, " *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 quantity to be paid, should be clear and plain to the contributor and every other person* ". It means the time, amount and method of payment should all be clear and certain so that the tax payer can adjust his income and expenditures accordingly. This principle removes all uncertainties in the payment of tax and ensures smooth functioning of the tax department.

3. Canon of Convenience : In the canon of convenience, **Adam Smith** states that, " *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* ". That is, the Tax should be levied and collected in such a way that is convenient to tax payer. For example, it may be in instalments, land revenue may be collected at the time of harvest, etc. This principle reduces the tendency of tax evasion considerably.

4. Canon of Economy : The next important canon of taxation is economy. According to **Adam Smith**, " *Every tax ought to be so contrived as both to take out and keep out of the pockets of the people as the little as possible over and above what it brings into the public treasury of the state* ". This principle states that the minimum possible amount should be spent on tax collection and the maximum part of the collection should be brought to the Government treasury.

5. Canon of Productivity : According to **C.F. Bastable**, the tax system should be productive enough i.e., it should ensure sufficient revenue to the Government and it should encourage productive activity by encouraging the people to work, save and invest.

6. Canon of Elasticity : The next principle advocated by **Bastable** is elasticity. The taxes should be flexible. It should be levied in such a way to increase or decrease the tax revenue depending upon the need. For example, during certain unforeseen situations like floods, war, famine, drought etc., the Government needs more amount of revenue. If the tax system is elastic in nature, then the Government can raise adequate funds without any extra cost of collection.

7. Canon of Diversity : According to this principle, there should be diversity in the tax system of the country. The burden of the tax should be distributed widely on the entire people of the country. The burden of the tax should be decscentralised so that every one should pay according to his ability. To achieve this, the Government should impose both direct and indirect taxes of various types. It should not depend upon one or two types of taxes alone.

8. Canon of Simplicity : This principles states that the tax system should be simple, easy and understandable to the common man. If the tax system is complex and vague, the tax payer cannot estimate his tax liability and it will cause irregularities in the payments and leads to corruption.

9. Canon of Expediency : According to this principle, a tax should be levied after considering all favourable and unfavourable factors from different angles such as economical, political and social.

10. Canon of Co-ordination : In a federal set up like India, taxes are levied by Central, State and Local Governments. So, there should be a proper co-ordination between different taxes imposed by various authorities. Otherwise, it will affect the people adversely.

11. Canon of Neutrality : This principle stresses that the tax system should not have any adverse effect. That is, it shouldn't create any deflationary or inflationary effects in the economy.

In a democratic country like India, the political factors are also influencing the tax policy of Government. While deciding an appropriate taxable system, the Government has to follow the above mentioned canons of taxation.

DIRECT AND INDIRECT TAXES

Direct Taxes

A direct tax is paid by a person on whom it is levied. In direct taxes, the impact and incidence fall on the same person. If the impact and incident of a tax fall on the same person, it is called as direct tax. It is borne by the person on whom it is levied and cannot be passed on to others. For example, when a person is assessed to income tax or wealth tax, he has to pay it and he cannot shift the tax burden to anybody else. In India, the direct taxes such as income tax, wealth tax, gift tax, estate duty are levied by Union Government. Tax on agricultural income, professional tax, land revenues, taxes on stamps and registrations, etc., are levied by State Governments. From the above discussion, it can be understood that the direct taxes levied in India take the form of taxes on income and property.

Merits of Direct Taxes

Direct taxes have the following merits :

according to their ability. The tax burden is not imposed on to the small section but it is widely spread. Thus, the indirect tax has wider scope.

3. Elastic : The revenue from the indirect taxes can be increased. Whenever the Government wants to raise its revenue, or lower it, it can be achieved by increasing and decreasing the rates of taxes on the commodities whose demand is in elastic.

4. Tax Evasion is Not Possible : Indirect taxes are included in the selling price of the commodities. So, evading of such tax becomes very difficult. If the person wants to evade the tax, it can be done only by refraining the consumption of the particular commodity.

5. Substantial Revenue : Indirect taxes yield substantial revenue to both Central and State Governments. The developing countries like India are heavily dependent on indirect taxes. Direct taxes have a limited scope in these countries because of low per capita income.

6. Progressive : Indirect taxes can be made progressive by imposing lower rates of taxes or giving exemption to the necessary articles and heavy taxes on luxurious articles. Thus, indirect taxes also confirm the principle of equity.

7. Effective Allocation of Resources : Indirect taxes have great influence in the allocation of resources among different sectors of the economy. Resources allocation can be made effective by imposing heavy excise duties on low priority goods and by granting reliefs to industries producing high priority goods. This results into mobilisation of resources from one sector to another positively.

8. Discourages the Consumption of Articles Injurious to Health : Indirect taxes discourages the consumption of certain commodities which are harmful to health. By imposing very high rates of taxes on commodities like liquors, drugs, cigarettes, etc., which are harmful to health their consumption can be reduced.

Demerits of Indirect Taxes

The following are the demerits of indirect taxes :

1. Ability to Pay Principle is Violated : Indirect taxes are not directly connected to the tax payers' ability to pay. Therefore, both the rich and poor equally pay the tax. Thus, the principle of ability to pay is violated. Indirect taxes are regressive in nature.

2. Uncertainty : If indirect taxes are not levied on the commodities of common consumption and levied only on luxurious articles, they tend to be inelastic. The quantity demanded will be affected by the imposition of the taxes. Thus, the revenue generated from them is uncertain.

3. Discourages Saving : Indirect taxes are included in the selling price of the commodities. Hence, the people have to spend more on the purchase of the goods. This, in turn affects the savings of the people.

4. High Cost of Collection : Indirect taxes are uneconomical as they involve high cost of collection.

5. Civic Consciousness is Not Created : Under indirect taxes, tax payers don't feel the burden of the tax. They are not aware of their contribution to the State. Thus, indirect taxes do not create the civic consciousness in the minds of the people

6. Inflationary : The indirect taxes cause an increase in the price all around. The increase in the prices of raw materials, finished goods and other factors of production creates inflationary trends in the economy.

Differences between Direct and Indirect Taxes

Direct and Indirect taxes differ among themselves on the following grounds :

1. Shiftability of the Burden of Tax : In the direct taxes, the impact and incidence fall on the same person. It is borne by the person on whom it is levied and is not passed on to others. For example, when a person is assessed to income tax, he cannot shift the tax burden to anybody else, and he himself has to bear it.

Whereas, in the case of indirect taxes, the impact and incidence fall on different persons. It is not borne by the person on whom it is levied. The burden of the tax can be shifted. For example, when the manufacturer of cement pays excise duty, he can shift the tax burden to the buyers by including the tax in the price of the cement.

2. Principle of Ability to Pay : Direct taxes conform to the principle of ability to pay. For example, people having income above Rs.40,000/- only are liable to pay income tax.

Whereas, indirect taxes are borne and paid by the weaker sections of the society also. As such, these taxes do not conform to the principle of ability to pay.

3. Measurement of Taxable Capacity : In the case of direct taxes, tax paying capacity is directly measured. For example, the taxable capacity for income tax is measured on basis of the income of the individual.

Whereas in the case of indirect taxes, taxable capacity is measured indirectly. The luxurious articles are levied at the higher rate of taxes on the assumption that they are purchased by the rich people. However, low rate is charged on the articles of common consumption.

4. Principle of Certainty : Direct taxes ensure the principle of certainty. Both the Government and the tax payer know what amount is to be paid and the procedures to be followed.

But in the case of indirect taxes, it is not possible. The tax payer does not know the amount of tax to be paid and the Government cannot predict the quantum of revenue generated from the indirect taxes.

5. Convenience : Direct taxes cause much inconvenience to the tax payers since they are to be paid in lump sum.

But the indirect taxes are paid by the consumers in small amounts as and when they purchase the commodities. Moreover, the tax payers need not follow any legal formalities in the payment of tax.

Thus, indirect taxes are more convenient to them.

6. Civic Consciousness : The burden of direct taxes are directly felt by the people. The tax payer is conscious of his contribution to the Government and interested in knowing whether the tax paid by him is properly used or not. In this way, it creates civic consciousness among the tax payers.

But indirect taxes do not raise such consciousness among the tax payers, because the taxes are paid by them indirectly.

7. Nature of Taxation : Direct taxes are progressive in nature. The rates of taxes go up with the increase in the tax base i.e., income of an assessee.

But indirect taxes are equally paid by rich and poor irrespective of their income. Thus, they are regressive in nature.

8. Removal of Disparity in Income and Wealth : Since the direct taxes are progressive in nature, they reduce the disparities of income and wealth among the people to a considerable extent.

Whereas indirect taxes have a negative effect. Actually they are widening the gap between the rich and poor when they are levied on the goods of common consumption.

9. Examples : The examples for direct taxes are income tax, wealth tax, gift tax, estate duty, etc.

The examples for indirect taxes are customs duty, excise duty, sales tax, etc.

Impact, Shifting and Incidence

The burden of a tax does not always lie on the person from whom it is collected. In many cases, it is borne by the other people also. Thus, the person who initially pays the tax may not be actually bearing its money burden as such. Hence, it is necessary to know who bears the immediate burden of tax and who bears the ultimate burden of tax. According to the law, the tax is collected from a particular individual or business unit which has paid the tax in the first instance and may transfer it to some one else. If such a shifting of tax takes place, the original tax payer has served only as a collecting agent.

In the process of taxing, three concepts are involved. They are :

1. A tax may be imposed on some person.

2. It may be transferred by him to another person i.e., second person.
3. It may be ultimately borne by the second person.

This can be explained with the help of the model shown in Figure 2.1.

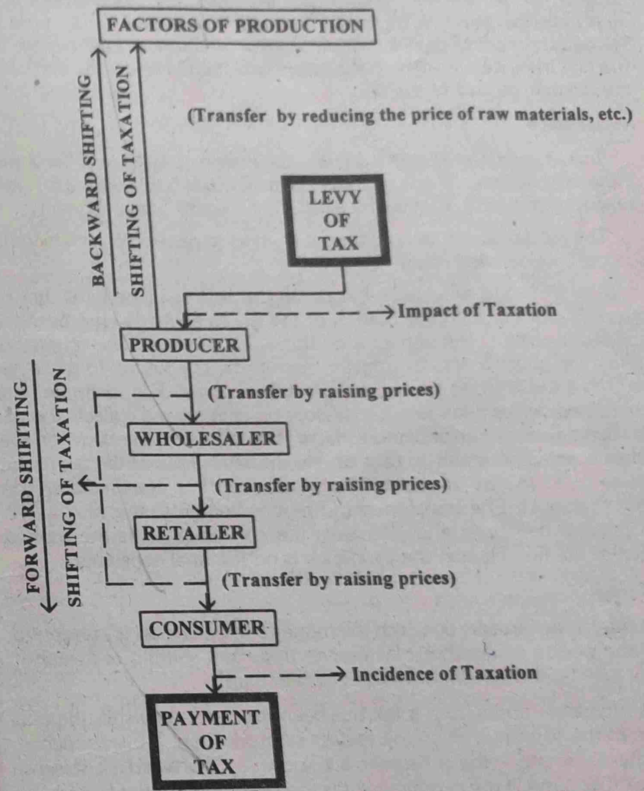

Fig. 2.1 Model of Impact, Shifting and Incidence

Thus,

a) Impact of a tax is on the person who bears the money burden in the first instance.

b) Shifting of a tax refers to the process by which the money burde of a tax is transferred from one person to another person.

c) Incidence of a tax refers to the money burden of a tax and is c the person who ultimately bears it.

import Duty whereas the tax on exports is known as Export Duty.

Key Differences Between Tax and Duty

The following are the major differences between tax and duty:

1. Tax is a financial obligation which is to be paid to the government compulsorily. Duty is a fee payable to the government on the manufacture and import/export of goods.
2. The duty itself is a type of tax.
3. Tax is charged on individuals, wealth, services and sales, whereas Duty is charged on goods.

and import/export of goods.

2. The duty itself is a type of tax.
3. Tax is charged on individuals, wealth, services and sales, whereas Duty is charged on goods.
4. There are two major types of taxes, i.e. Direct Tax and Indirect Tax. Conversely, the major types of duties are Excise Duty and Customs Duty.
5. The Central Government or State Government can impose taxes, but only the Central Government has got the authority to levy duty.

Conclusion

In India, the administration of tax and

they are applicable from a consumer's perspective.

Different Types of Indirect Tax

There are different types of indirect tax in India. However, after the implementation of GST, all these indirect taxes were bundled into one singular tax for the citizens of India. We will have a look at the different types of indirect tax in India:

1. **Service tax:**This tax is levied by an entity in return for the service provided by them. The service tax is collected by the Government of India and deposited with them.

2. **Excise duty:**When any product or good is manufactured by a company in India, then the tax levied on those goods is called the Excise Duty. The manufacturing company pays the tax on the goods and in turn recover the amount from their customers.

3. **Value Added Tax:**Also known as VAT, this type of tax is levied on any product sold directly to customer and are movable. VAT consists of Central Sales Tax which is paid to the Government of India State Central Sales Tax which is paid to the respective State Government.

4. **Custom Duty:**This a tax levied on the goods imported to India. Sometimes, Custome Du also levied on products which are exported India.

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4. **Custom Duty:**This a tax levied on the goods imported to India. Sometimes, Custome Duty is also levied on products which are exported out of India.
5. **Stamp Duty:**This is a tax levied on the transfer of any immovable property in a state of India. The state government in whose state the property is located charges this type of tax. Stamp tax is also applicable on all legal documents too.
6. **Entertainment Tax:**This tax is charged by the state government and is applicable on any products or transactions related to entertainment. Purchasing of any video games, movie shows, sports activities, arcades, amusement parks, etc. are some of the products on which Entertainment Tax is charged.
7. **Securities Transaction Tax:**This tax is levied during the trading of securities through Indian Stock Exchange.

TOP

Features of Indirect Tax

Here are the key features of indirect taxes: