Reforms in Indian Taxation Systems – An overview

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Abstract

This paper author explore the reforms that can be undertaken Indian taxation system to empower the employed and salaried class and also the consumers producers. The word tax comes from a Latin word "taxo". A tax is a compulsory fee or financial charge levied by a government on an individual or an organisation to raise revenue for public works. The collected amount is then used to fund different public expenditure programmes. Failure in payment of taxes or resisting to contribute towards it invites punishment under the pre-defined law.

The taxation system in India traces its roots to ancient texts like Manusmriti and Arthashastra. As prescribed by these texts, artisans, farmers, and traders hundreds of years ago would pay taxes in the form of silver, gold and agricultural produces. Taking clues from these texts and with some added tweaks, the basis for the modern tax system in India was laid by the British when Sir James Wilson introduced income tax in 1860. At the time of independence, the newly-formed Indian Government cemented the system to catalyze the economic progress of the country and also to eradicate income and wealth disparity.No matter where you live in the world, the one thing that you can always count on is that you will be paying taxes to the local government. Taxes come in various forms such as state taxes, central government taxes, direct taxes, indirect taxes and so on. For simplicity's sake, we will be dividing the types of taxes payable in India into two categories – direct taxes and indirect taxes. This differentiation is based on how the tax is being paid to the government. In the following sections, we will discuss in brief the common taxes that an Indian citizen is liable to pay.Tax can be defined in very simple words as the government's revenue or source of income. The money collected under the taxation system is put into use for the country's development through several projects and schemes. The Indian Constitution authorizes the Central and the State Governments to levy taxes.

The Parliament passes laws to approve taxes collected by the Central Government. In the case of the State Governments, the State Legislature holds this power. Also, the local governing and civic bodies too have the right to levy certain taxes.

Keywords— Manusmriti , Arthashastra, India, the Central Government, Taxation

Introduction

There are two ways to classify different types of taxes in India:

Taxes Levied by the Central Government and State Governments

By the Central Government: These include income taxes (the exception being the tax on agricultural income), customs duties, corporation taxes, excise duties, estate duty and more

By the State Government: Taxes on agrarian incomes, VAT (value-added taxes), electricity consumption and sale taxes, land revenues, tolls and more

By the Local Civic Bodies: Municipal corporations and other local governing bodies collect taxes like property taxes

Direct and Indirect Taxes

Direct Taxes: The individuals directly pay these taxes to the respective governments. The most notable examples include income tax, capital gains tax, perquisite tax, corporate tax, and securities transaction tax.

Indirect Taxes: These taxes are not directly paid to the governments but are collected by the intermediaries who sell or arrange products and services. Service tax, sales tax, octroi, customs duty, value-added tax, and excise duty are some of the top examples.

The Concerned Authorities

In 1964, the Central Board of Revenue was constituted to govern the taxation system in the country. Two bodies formed under the board include:

Central Board of Direct Taxes (CBDT): Plans and administers the direct taxes

Central Board of Excise and Customs (CBEC): Administers service tax, customs and excise duties

Highlights of Taxation System 2017

Revised Income Tax Slabs: In a significant relief to the low-income individuals, the Union Budget presented in 2017 revamped the tax rate for different brackets. Income up to Rs.2.5 Lakhs is entirely tax-free. 5% of the total income exceeding Rs.2.5 will be applicable if the income is within Rs.2.5 Lakhs & Rs.5 Lakhs. From Rs.5 Lakhs to Rs.10 Lakhs, 20% of the total income exceeding Rs.5 Lakhs + Rs.12,500 will be levied. Similarly, Rs.1,12,500 + 30% of total income exceeding Rs.10 Lakhs will be levied as income tax.

Goods and Service Tax (GST): Passed in 2016, but levied in July 2017, GST brings various indirect taxes levied by the Central and the State Governments under a single comprehensive indirect tax.

Central Board of Indirect Taxes and Customs (CBIC): Another significant development was renaming CBEC to CBIC under the newly-levied GST.

The Government of India penalizes offenders, who don't pay taxes, through penalties ranging from fines to imprisonment. Paying taxes on time and with honesty is indeed beneficial for all.

Objective:

This paper intends to study and explore the reforms that have been taken in the taxation system by Indian government over the years and scope of taxation mechanism in in the present world

Definition and Main Highlights of the Tax Structure in India

The government makes it helpful for regular taxpayers by allowing tax exemptions up to a certain limit. Premiums of life insurance policies and benefits availed through them are eligible for tax deductions under Section 80C and Section 10(10D) of the Income Tax Act of India. It is often seen that ULIP tax-saving instruments have high demand as these investment plans let you avail of

both investments as well as insurance benefits. Investing in top-performing ULIP funds becomes beneficial as you save on taxes in addition to getting a sizeable corpus. Thus, the ULIP tax saving instrument stands to be a perfect tool these days.

The tax structure in India is a three-tier federal structure. The central government, state governments, and local municipal bodies make up this structure. Article 256 of the constitution states that "No tax shall be levied or collected except by the authority of law". Hence, each and every tax that is collected needs to backed by an accompanying law.

The Indian tax structure allows for two types of taxes—**Direct and Indirect Tax.**

Direct Tax Reforms:

It is levied directly on individuals and corporate entities. This tax cannot be transferred or borne by anybody else. Examples of direct tax include income tax, wealth tax, gift tax, capital gains tax.

Income tax is the most popular tax within this section. Levied on individuals on the income earned with different tax slabs for income levels. The term 'individuals' includes individuals, Hindu Undivided Family (HUF), Company, firm, Co-operative Societies, Trusts.

Indirect Tax Reforms:

These are taxes which are indirectly levied on the public through goods and services. The sellers of the goods and services collect the tax which is then collected by the government bodies.

Examples of indirect taxes are

Value Added Tax (VAT)– A sales tax levied on goods sold in the state. The rate depends on the government.

Octroi Tax– Levied on goods which move from one state to another. The rates depend on the state governments.

Service Tax– Government levies the tax on service providers.

Customs Duty– It is a tax levied on anything which is imported into India from a foreign nation.

Tax Collection Bodies:

The three bodies which collect the taxes in India have clearly defined the rules on what type of taxes they are permitted to collect.

The Central Government: income tax, custom duties, central excise duty.

The State Governments: tax on agricultural income, professional tax, value- added tax, state excise duty, stamp duty.

Local Bodies: property tax, water tax, other taxes on drainage and small services.

GST:

In India, the three government bodies collected direct and indirect taxes until 1 July 2017 when the Goods and Services Act (GST) was implemented. GST incorporates many of the indirect taxes levied by states and the central government. What does the GST mean for your money?

Some of the taxes GST replaced include:

- Sales Tax
- Central Excise Duty
- Entertainment Tax
- Octroi
- Service Tax
- Purchase Tax

It is a multi-stage destination-based tax. Multi-stage because it is levied on each stage of the supply chain right from purchase of raw material to the sale of the finished product to the end consumer whenever there is value addition and each transfer of ownership.

Destination-based because the final purchase is the place whose government can collect GST. If a fridge is manufactured in Delhi but sold in Mumbai, the Maharashtra government collects GST.

A major benefit is the simplification of taxation in India for government bodies.

GST has three components:

- CGST- Stands for Central Goods and Services Act. The central government collects this tax on an intrastate supply of goods or services.
- (Within Maharashtra)
- SGST: Stands for State Goods and Services Tax. The state government collects this tax on an intrastate supply of goods or services.
- (Within Maharashtra)
- IGST: Stands for Integrated Goods and Services Tax. The central government collects this for inter-state sale of goods or services.

Other Government Bodies entrusted:

For a smooth implementation of the Indian tax system, there are bodies dedicated to it. Popularly known as the revenue authorities.

CBDT: The Central Board of Direct Taxes is a part of the revenue department under the Ministry of Finance. It has a two-fold role. One, it provides important ideas and inputs for planning and policy with regard to direct tax in India. Second, it assists the Income Tax department in the administration of direct taxes.

CBEC: The Central Board of Excise and Customs deals with policy formulation with regard to levy and collection of customs and central excise duties and service tax.

CBIC: Post GST implementation, the CBEC has been renamed as the Central Board of Indirect Taxes & Customs (CBIC). The main role of CBIC is assisting the government in policy-making matters related to GST.

The tax system in India for long was a complex one considering the length and breadth of India. It is hoped that post GST implementation, the process becomes smoother.

Income Tax Deductions recent changes

Those who have taxable income in excess of Rs. ₹ 2.5 lakhs are liable to pay income tax as per their applicable slab. However, there are a few tax savings options that can be used to reduce the income tax payable by the individual. Examples of such deductible expenditures include ELSS, Mutual Funds, PPF, EPF, tax saver fixed deposits, post office saving schemes, life insurance, health insurance and others. A majority of these deductible expenditures are available under sections 80C and 80D of the Income Tax Act, 1961.

Tax Deducted at Source

Tax Deducted at Source or TDS is considered to be one of the most common ways a salaried individual's tax is paid by the employer to the government. In this case, investment declarations provided during the current/previous year, are used to determine the tax liability of the individual and this amount is equitably distributed and deducted from the salary payable every month. In case further deductions are availed by the individual at a later date, the excess TDS with interest (if applicable) is refunded to the employee. Other cases of TDS can occur in the case of interest paid on fixed deposits. In this case also, the tax assessee can get a refund after filing the Income Tax Return (ITR).

Income Tax Notice

As with any type of notice sent out by the government, an Income Tax Notice is often believed to be a bad sign. Where in fact, all it might be is a clarification request regarding some aspect of your ITR. Earlier such notices were sent out using the postal system, but over the years, this has changed and with the advent of e-Filing, the Income Tax Department sends out emails that ask you to log on to your e-Filing account and view the notice you have received. No matter what, such a notice must never be ignored and

responded to in the prescribed manner. If the IT Department does not get a response from you subsequent to sending out multiple notices, they can initiate criminal proceedings against you or fine you depending on the severity of your situation.

Goods and Services Tax (GST): New age reforms

Considered to be the greatest tax reform that India has undergone since its independence, the Goods and Services Tax or GST is all set to be implemented from July 2017. This indirect tax is designed to provide uniformity to taxes levied on products and services across India. To that effect, the GST will replace all other taxes levied by the state and central governments. As per currently available data, goods and services will be taxed according to specific rates of 0%, 5%, 12%, 18% or 28%, while a few other goods/services have been classified as exempt.

Value Added Tax (VAT)

This was one of the leading indirect taxes of the pre-GST era in India and this is pretty common all over the world. VAT is applied whenever there is a value-addition to the inputs/raw materials used in order to produce the final product for sale. If a certain product is bought and sold multiple times as raw material or semi-finished product till it is available as the final product, the VAT will be applicable in each downstream step provided there is a value-addition activity involved.

Sales Tax

This is an indirect tax levied on the sale of goods or services and is an integral tax during the pre-GST period. As opposed to VAT, sales tax is considered to be an ad -valorem tax as it is computed based on the gross value of the sale even if there is no value addition. Sales tax is often considered to be a tax on tax or double taxation situation as it is levied every time a good or service is sold irrespective of whether there has been an increase in value or not.

Service Tax

Introduced in India as part of the Finance Act, 1994, the service tax is best defined as an indirect tax payable to the government by a pre-determined group of service providers. These service providers subsequently pass this tax on to their customers. Some of the common examples of establishments that charge customers service tax include hotels, restaurants, mobile connection providers, etc.

Excise Duty

- Central Excise Duty is a form of indirect tax levied under Central Excise Tariff Act, 1985
- It is levied on goods manufactured in India for domestic consumption
- The manufacturer pays the tax after production of goods when it is sent to the market

- After the implementation of GST, the tax has been subsumed under Goods and Services Tax

Custom Duty

Tax levied on import and export of goods is called customs duty

It is primarily aimed at controlling and regulating entry and exit of goods

Customs duty vary from product to product and from time to time in order to protect the domestic industry

Custom duty depends on various international agreements under WTO, FTA, etc.

Corporate Tax

It is the tax levied on income of both domestic and foreign companies and is levied under the Income Tax Act, 1961

- Corporate Tax is imposed on "net income" of a company registered under Companies Act, 1956
- Only the income earned in India is taxed under corporate tax
- Corporate tax rate for domestic companies is 30% and foreign companies is 40%
- A surcharge is also levied on companies depending on their earnings and revenues

Securities Transaction Tax

- Tax levied on value of securities transacted through recognized stock exchanges is called Securities Transaction Tax
- This direct tax is levied and collected by the Central Government

The tax is levied on products such as stocks, share, bonds, debentures, derivatives, equity oriented mutual funds, etc.

- STT is not imposed on off-market transactions
- STT applicable on redemption of mutual funds or ETFs is 0.025%
- STT charged on sale of MFs or ETFs is 0.001% and is levied only on the seller

Tax Reforms : Road ahead

Tax reform can reduce tax evasion and avoidance, and allow for more efficient and fair tax collection that can finance public goods and services. It can make revenue levels more sustainable, and promote future independence from foreign aid and natural resource revenues (Sustainable revenue and reducing aid and natural resource dependence). It can improve economic growth (Economic growth) and address issues of inequality through redistribution and behaviour change (Inequality and redistribution).

Conclusion

Tax is a mandatory liability for every citizen of the country. Arthasastra mentioned that each tax was specific and there was no scope for arbitrariness. Tax collectors determined the schedule of each payment, and its time, manner and quantity being all pre-determined. The land revenue was fixed at 1/6 share of the produce and import and export duties were determined on ad-valorem basis. The import duties on foreign goods were roughly 20% of their value. Similarly, tolls, road cess, ferry charges and other levies were all fixed. In India, this tax was introduced for the first time in 1860, by Sir James Wilson in order to meet the losses

sustained by the Government on account of the Military Mutiny of 1857. In 1918, a new income tax was passed and again it was replaced by another new act which was passed in 1922.This Act remained in force up to the assessment year 1961-62 with numerous amendments.

In consultation with the Ministry of Law finally the Income Tax Act, 1961 was passed. The Income Tax Act 1961 has been brought into force with 1 April 1962. It applies to the whole of India and Sikkim (including Jammu and Kashmir).

Tax reform is generally undertaken to improve the efficiency of tax administration and to maximise the economic and social benefits that can be achieved through the tax system. A tax itself can be defined as 'a financial charge or other levy imposed upon a taxpayer (an individual or legal entity) by a state, or the functional equivalent of a state' (Granger, 2013, p. 1). Taxes can include direct taxes on income and wealth (e.g. personal and corporate income taxes, property tax), and indirect taxes on consumption (e.g. Value Added Tax (VAT), excise duties).

There has been increasing global and donor interest in developing country domestic revenue mobilisation, and in particular taxation (Mascagni et al., 2014; Fjeldstad, 2014). There is growing recognition of the role of taxation in state-building, in terms of enhancing state capacity and state-society relations. The 2008 financial crisis brought about a temporary fall in aid levels, and a renewed focus by donors on aid effectiveness and ensuring that donors support rather than discourage developing countries' own revenue-raising efforts. Some activists also argue that the current international tax regime is dysfunctional, creating a race to the bottom to offer favourable, but infeasible, tax conditions to attract investment which further exacerbate inequality.

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