

Taxation in India (Part – 1)

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The taxation system in India is such that the taxes are levied by the Central Government and the State Governments. Some minor taxes are also levied by the local authorities such as the Municipality and the Local Governments.

To run the government and manage the affairs of a state, money is required. So the government imposes taxes in many forms on the incomes of individuals and companies.

Classification of Taxes

Broadly taxes are divided into two categories:

1. Direct Taxes
2. Indirect Taxes

Direct Taxes

A direct tax can be defined as a tax that is paid directly by an individual or organization to the imposing entity (generally government). A direct tax cannot be shifted to another individual or entity. The individual or organization upon which the tax is levied is responsible for the fulfillment of the tax payment.

The Central Board of Direct Taxes deals with matters related to levying and collecting Direct Taxes and formulation of various policies related to direct taxes.

A taxpayer pays a direct tax to a government for different purposes, including real property tax, personal property tax, income tax or taxes on assets, FBT, Gift Tax, Capital Gains Tax, etc.

Indirect Taxes

The term indirect tax has more than one meaning. In the colloquial sense, an indirect tax such as sales tax, a specific tax, value-added tax (VAT), or goods and services tax (GST) is a tax collected by an intermediary (such as a retail store) from the person who bears the ultimate economic burden of the tax (such as the consumer).

The intermediary later files a tax return and forwards the tax proceeds to the government with the return. In this sense, the term indirect tax is contrasted with a direct tax which is collected directly by the government from the persons (legal or natural) on which it is imposed.

Indirect Taxes in India

Indirect taxes in India can be broadly classified into:

- Production of goods: Excise or CenVAT
- Distribution of goods: Sales Tax
- Production and Distribution of services (because they can't be separated):
- Service Tax

In India, generally, a tax on production or manufacturing (Excise) is levied by the centre, and a tax on sales (Sales Tax) is levied by the states.

Excise duties

Excise duty (Central VAT) is a tax on the manufacture of goods within the country. Excise duties are levied under the Central Excise and Salt Act, 1944, the Excise Tariff Act, 1985, and the Modified Value Added Tax (MODVAT) scheme or CENVAT.

The rates of excise duty levied vary depending inter alia on the nature of the item manufactured, the nature of the manufacturing concern, and the place of ultimate sale.

The duty rates are either ad valorem (i.e. a fixed percentage of the cost of production), specified (a fixed rate depending on the nature of the manufactured item, for example, length of product or count of product), or a combination of both.

The MODVAT scheme, introduced in 1986, on the recommendation of the L K Jha Committee, applies to certain specific items.

The objective of this scheme is to limit the cascading effect of duty incidence on several goods subject to excise which are further used as inputs for other excisable goods.

Under the scheme, MODVAT credit can be claimed on the purchase of raw materials on which excise have been paid.

This MODVAT credit can be used to set off excise duty payable on subsequent manufacture of goods.

Sales tax

Sales tax is levied on the sale of a commodity that is produced or imported and sold for the first time.

If the product is sold subsequently without being processed further, it is exempt from sales tax. Sales tax is levied by either the Central or the State Government, Central Sales tax, or 4% is generally levied on all inter-State sales.

State sales taxes that apply to sales made within a State have rates that range from 4 to 15%. However, exports and services are exempt from sales tax.

Service tax

Service tax is a part of Central Excise in India. It is a tax levied on services provided in India, except the State of Jammu and Kashmir.

Some of the important Direct taxes:-

Fringe Benefit Tax

To reduce the profit on booked entry, many companies started providing various benefits to their employees and maintain them under their input cost. Thus reducing the profit which in turn leads to less taxation by the government.

Therefore government-imposed Fringe Benefits Tax (FBT) which is fundamentally a tax that an employer has to pay instead of the benefits that are given to his/her employees. It was an attempt to comprehensively levy a tax on those benefits, which evaded the tax.

The list of benefits encompassed a wide range of privileges, services, facilities, or amenities which were directly or indirectly given by an employer to current or former employees, be it something simple like telephone reimbursements, free or concessional tickets, or even contributions by the employer to a superannuation fund.

FBT was introduced as a part of the Finance Bill of 2005 and was set at 30% of the cost of the benefits given by the company. This tax needed to be paid by the employer in addition to the income tax, irrespective of whether the company had an income-tax liability or not.

The fringe benefits tax was abolished in the 2009 Union budget of India.

Minimum Alternate Tax

The concept of Minimum Alternate Tax (MAT) was introduced in the direct tax system to make sure that companies having large profits and declaring substantial dividends to shareholders but who were not contributing to the Government by way of corporate tax, by taking advantage of the various incentives and exemptions provided in the Income-tax Act, pay a fixed percentage of book profit as minimum alternate tax.

As per the Income Tax Act, if a company's taxable income is less than a certain percentage of the booked profits, then by default, that much of the book profits will be considered as taxable income and tax has to be paid on that.

It is called MAT and is a direct tax. It was introduced to deter some companies who managed their account in such a way that they end up paying zero or no tax to the government.

The current rate of MAT is 18.5%.

Alternate Minimum Tax

Under the existing provisions of the Income-tax Act, Minimum Alternate Tax (MAT) and Alternate Minimum Tax (AMT) are levied on companies and limited liability partnerships (LLPs) respectively.

That means what is MAT to the companies, AMT is to the LLPs. However, no such tax is levied on the other form of business organizations such as partnership firms, sole proprietorship, an association of persons, etc.

To widen the tax base vis-à-vis profit linked deductions, it is proposed to amend provisions regarding AMT contained in the Income-tax Act to provide that a person other than a company, who has claimed deduction under any section (other than section 80P), shall be liable to pay AMT.

Under the proposed amendments, where the regular income-tax payable for a previous year by a person (other than a company) is less than the alternate minimum tax payable for such previous year, the adjusted total income shall be deemed to be the total income of such person and he shall be liable to pay income-tax on such total income at the rate of eighteen and one-half percent.