GOODS AND SERVICES TAX

1. Basics of Taxation

Introduction

The word "tax" was derived from the Latin word "taxore", which means to estimate, to appreciate or value. Tax is the amount paid by the person staying within a territorial limit of a country. It is levied on individuals, property, business, service etc. it is an important and significant source of revenue to the government.

The taxation system in the Republic India is quite well-structured. The development of revenue of the Finance Ministry of the Government of India is responsible for the computation, levy as well as collection of most of the taxes in the country. A good taxation system is helpful to achieve various socio-economic objectives.

Concept of tax

The taxation system is an important concept in the economy of a country. In order to run the Government and manage the affairs of a state, money is required. So, the Government imposes taxes in different forms on person. Government utilizes this revenue for developing infrastructure, providing health care, education, subsidies and other welfare schemes.

The Indian tax system has undergone enormous reforms in the past decades for better compliance, better enforcement, easy tax payments. Tax rates are streamlined, and tax laws are also simplified. The effect of rationalizing the tax administration is an ongoing process.

In India, tax system is fully controlled, imposed and updated by the Central Government and State Government. The power to collect the taxes stems from the Indian Constitution, which divides the power between Central and State Government.

Meaning of Tax

Tax is a duty levied by or imposed by the Central Government or State Government or legal entities.
Tax is a compulsory levy under certain conditions by Central or State or local bodies on the income earned by the person during the previous year.
Tax is a compulsory contribution from a person to the expenses incurred by the state in common interest of all without reference to specific benefits on any individuals.

Purpose of Taxation

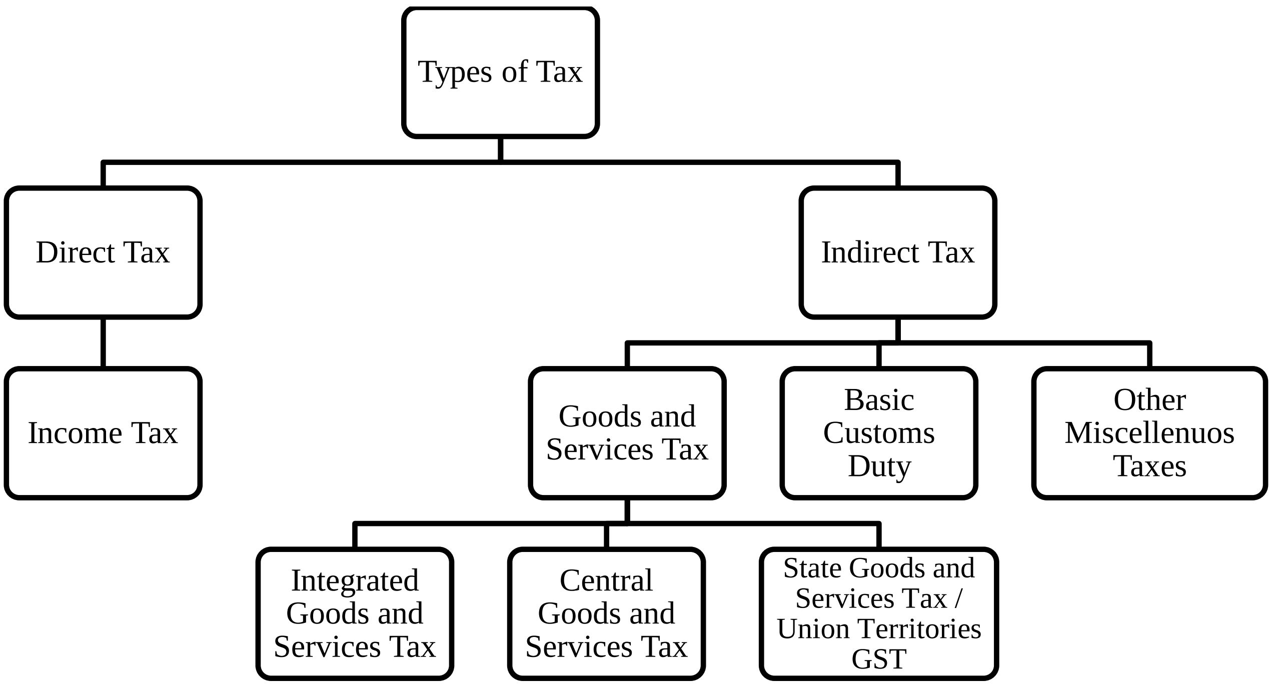
The main purpose of taxation is to accumulate funds for the functioning of the Government machineries. A Government can run its administration only through public funding which is collected in the form of tax.

Therefore, it can be well understood that the purpose of taxation is very simple and obvious for proper functioning of the country.

Following are the main purpose of taxation:

a) To increase the effectiveness and productivity of the country.
b) To improve the services of Government.
c) To improve the employment at all industry level.
d) Induction of modern technology into the system.
e) Rationalization of terms and conditions of the economic system
f) Rationalization of employment

Types of Taxes in India



Basically, taxes in India are classified into two types, they are as follows:

1) Direct Tax: Direct Tax is a kind of Tax where incidence and impact falls on same person. Where ‘Incidence’ means liability to pay the tax to Government and ‘Impact’ means burden of paying tax. The Direct taxes are directly paid to the Central Government by the assesses.

The Central Board of Direct Taxes **(CBDT),** which is governed by the Department of revenue, administers the direct taxes in India.

Examples: Income Tax, Wealth Tax, Corporate Tax etc.,

Advantages of Direct Tax

1. **Promotes Ethics:** Since Direct Taxes are collected based on the ability or capability of a person to pay, it promotes equality among taxpayers and citizens. Every taxpayer under direct tax are charged different rate of tax depending upon their income group.
2. **Economic and Social balance:** The Government has launched well balanced tax slabs depending on the individual's earnings and age. The tax slabs are also determined based on the economic situation of the country. Exemptions are also put in place so that all income inequalities are balanced out.
3. **Productivity:** Direct is progressive in nature. As there is a growth in the number of people who work and community, the returns from the direct taxes also increase. This is the reason the direct taxes are considered as productive and yields large revenue to the Government.
4. **Inflation is curbed:** Tax is increased by Government during inflation. The increase in taxes reduces the necessity for goods and services, which the inflation to compress.
5. **Certainty:** Due to the presence of direct tax, there is a sense of certainty for the Government and the taxpayer, the amount that must be paid and the amount that must be collected is known by the taxpayer and the Government respectively.

Disadvantages of Direct tax

1. **Inconvenient:** Direct tax do not confirm to the canon of convenience as returns of income tax, wealth tax etc., are to be filed on time and complete records are to be maintained up-to date by each individual taxpayer.
2. **Evasion:** If the system is not water-tight, there is always a chance of tax evasion by manipulating the law like, submitting false returns, presenting false income etc.,
3. **Uneconomical:** Direct taxes are uneconomical as the tax base is narrow. Further elaborate machinery is required for their collection as each and every assesses has to be contacted individually and properly verified to prevent tax evasion.
4. **Narrow based:** Direct taxes are generally narrow based, therefore large section of masses is untouched and to extent, they fail to achieve their objective of promoting civic sense among the citizens.
5. **Disincentive:** Due to imposition of direct taxes on investment, savings, it will discourage savings and investments. In that case the country will suffer economically. A high level of taxation discourages investment and enterprise in the country.

Direct taxes are further classified as below,

a) **Income Tax:** Income tax is one of the most well-known direct tax. Income tax is imposed by the government on the annual income generated by businesses and individual. Income tax is calculated as per the provisions of Income Tax Act, 1961. Following are the sources of Income:

- Income from Salary
- Income from House Property
- Profits and Gains from business and profession
- Income from Capital gains
- Income from Other sources

Other types of Direct taxes

- ***Wealth Tax****: The liability of wealth tax arises from the ownership of properties and is paid every year based on the market value of the property. Property owners must pay this tax irrespective of whether the property earns them income or not. It was abolished in 2016.*

- ***Corporate Tax****: Corporate tax is levied on domestic companies that are different from shareholders. This tax also payable by foreign corporations whose income arises or deemed to arise in India. It includes the following:*

    - ***Security Transaction Tax (STT)****: This liability arises from income earned through taxable security transactions.*

    - ***Dividend Distribution Tax (DDT)****: This tax is levied on any amounts that are declared, distributed, or paid by domestic entities as dividends to the shareholders. Foreign companies are exempted from DDT.*

    - ***Fringe Benefit Tax (FBT)****: Such direct taxes are paid on fringe benefits provided to the employees by employers.*

    - ***Minimum Alternate Tax (MAT)****: Levied on zero tax companies whose accounts are prepared as per the guidelines of companies Act.*

- ***Capital Gains Tax****: The capital assets of an individual refer to anything owned for personal use or for the purpose of an investment. For, businesses, the capital asset is anything that can be used for more than one year and is not intended to be sold or liquidated during the course of business operation.*

- ***Agricultural Tax***: *Agriculture income means –*
  - *Any rent or revenue derived from a land situated in India and used for agricultural purposes (i.e. basic operations like tilting of land, sowing of seeds, planting, harvesting, irrigation should be carried out on land).*
  - *Any rent or revenue received from a house property situated in the immediate vicinity of agricultural land and used for residences of the owner or tenant or for storing agricultural equipment's or produces.*
- ***Professional Tax***: *It is a tax on all kinds of professions, trades, and employment and levied based on the income of such profession, trade and employment.*

2) Indirect Taxes: Indirect tax is a kind of tax where in incidence and impact falls on two different persons. In other words, an individual pays indirect tax to the Government but through an intermediary. This intermediary then passes it on to the Government.

Central Board of Indirect taxes and Customs **(CBIC)**, Department of Revenue, Ministry of Finance is responsible for formulation of policy relating to levy and collection of indirect taxes.

Examples: Goods and Services Tax, Basic Customs Duty, Road tax etc.,

Advantages of Indirect Taxes

1) **Everyone can contribute**: Unlike, direct tax which is paid only by individuals in certain income slabs and not others. But under indirect taxes, the tax has to be paid by each and every one who purchases the commodities.
2) **Convenient:** Indirect taxes are convenient as far as charging them is concerned. Firstly, the tax rates will be very nominal, and consumers do not feel burdened when paying such small amounts. Secondly, these taxes are hidden in nature, they are included in the price of the goods which means consumers will be aware of the price of the commodity.
3) **Evasion is not possible**: Indirect taxes cannot be evaded as the indirect taxes are included in the price itself.
4) **Flexible:** Indirect taxes are flexible or elastic in the sense that it can be revised in accordance with the requirements of the Government.

Disadvantages of Indirect taxes

1) **Regressive in nature:** The indirect taxes collected by both rich and poor are same, it can be deemed as unfair to the poor. Indirect tax will not be considering the ability or capability of an individual, it is applicable to anyone who purchases makes purchases, and while the rich can afford to pay tax, the poor will be burdened by the same amount of tax.

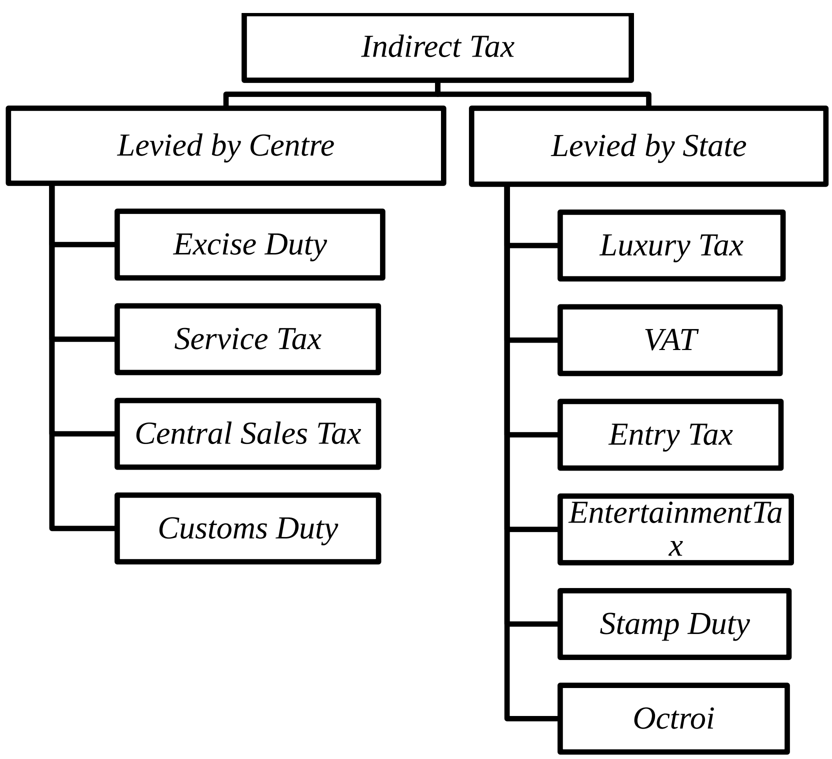
2) **It increases the price of commodities**: Sellers cannot always calculate and collect the exact fraction of tax applicable on all commodities that they sell. And hence they consciously charge more than the tax amount so they can be sure that every buyer paid the tax.

3) **No civic sense:** Indirect tax do not create civic awareness among illiterate taxpayers because most of the people are still not aware that they are paying a tax because it is hidden in nature.

4) **Uncertain:** Indirect tax fails to satisfy the canon of certainty because the revenue accruing from the indirect taxes cannot be estimated properly.

Types of Indirect Taxes in India

Classification of Indirect Taxes (before GST)



Indirect Taxes levied by Central Government

- ***Excise Duty:*** *It is an indirect tax levied on those goods which are manufactured inside India. The taxable event in this case is manufacture and the liability of Central Excise Duty arises as soon as* *the goods are manufactured, it was based on the principal of Origin. It was governed by Central Excise Act, 1944.*

- ***Service Tax:*** *Service tax is a tax which is levied on the services rendered by an entity or an individual. It was governed by Service Tax Act, 1994.*

- ***Central Sales Tax:*** *It is a tax on sales of goods levied Central Government. Central Sales Tax is levied on sales made in case of inter-state sales only. It was governed by Central Sales Tax Act, 1956.*

- ***Customs Duty:*** *It is an indirect tax which levied on goods which are imported into or exported from India. It was governed by Customs Act, 1962. Basic Customs Duty, Anti-Dumping Duty, Special Additional Duty, Counter-veiling Duty are the different types of customs duty.*

Indirect Taxes levied by State Government

- ***Luxury Tax:*** *A luxury tax is a sales tax or surcharge levied only on certain products or services that are considered as non-essential or accessible only to higher-income group of people.*

- ***Value Added Tax:*** *It is multilevel tax system on goods. It is levied on commodity whenever it adds value at any point in the supply chain, from production to sale.*

- ***Entry Tax****: It is a tax on the movement of goods from one state to another. It is levied by recipient state to protect its tax base.*

- ***Entertainment Tax****: Entertainment tax is levied by state on every financial transaction that is related to entertainment and is reserved primarily for the state Government.*

- ***Stamp Duty:*** *It is levied by State Governments on the transfer immovable property located in their state. It is also levied on all legal documents.*

- ***Octroi:*** *Octroi is the kind of tax or charge which is collected by State Government on those goods that have been bought into state for the purpose of personal use and sale.*

Classification of Indirect Tax (After GST)

1) **Goods and Services Tax:** Goods and Services Tax is a broad based and a single comprehensive tax levied on goods and services consumed. GST is levied at every stage of the production-distribution chain with applicable setoffs in respect of the tax remitted at previous stages. It is a destination-based tax.

a) **Integrated Goods and Services Tax:** Integrated Goods and Services Tax means tax levied under IGST Act on supply of any goods or services in the course of inter-state trade or commerce.

b) **Central Goods and Services Tax:** Central Goods and Services Tax is a tax levied and collected on Intra-state supply of goods or services or both by Central Government.

c) **State Goods and Services Tax:** State Goods and Services Tax is a tax levied and collected by State Government on every Intra-state supply of goods or services or both.

Union Territories Goods and Services Tax: UTGST will be levied on the supply of goods or services or both that takes place within the boundaries of union territory.

2) **Basic Customs Duty:** It is an indirect tax which levied on goods which are imported into or exported from India. It was governed by Customs Act, 1962. Special Additional Duty, Counter-veiling are replaced by GST. Only Basic Customs Duty will be levied.

3) **Other Miscellaneous taxes:** These are the indirect taxes which are not subsumed under GST.

- Motor Vehicle Tax
- Stamp Duty
- Excise on Alcohol for human consumption
- Excise on Petroleum products
- Electricity tax and Water Tax
- Toll

Differences between Direct Taxes and Indirect Taxes

Basis of Difference	Direct Tax	Indirect Tax
Meaning	Direct tax is a kind of tax where ‘incidence’ and ‘impact’ falls on same person.	Indirect tax is a kind of tax where ‘incidence’ and ‘impact’ falls on two different persons.
Burden of Tax	The person on whom the direct tax is levied bears the burden and it cannot be shifted.	The burden of tax can be shifted from one person to another person.

Types	The types of direct tax are Income Tax, Corporate Tax, Capital gains tax.	The major types of indirect tax are GST and Basic Customs Duty
Nature of tax	Direct tax is progressive in nature (i.e. as and when the income of the person increases the amount of tax paid by them will also be increased)	Indirect tax is regressive in nature
Taxable Value	The income of the assessee will be the taxable value	The value of supply of goods and/or services will be the taxable value
Inflation	Direct tax helps in reducing the inflation	Indirect tax promotes the inflation.
Evasion	There is a high chance of tax evasion under direct tax.	Tax evasion is hardly possible because the tax is included in the price of goods and services.
Imposition, Collection and payment	Direct tax is imposed, collected and paid by assessee.	Indirect Tax is imposed and collected from consumers on purchase of goods and services but paid by intermediary.
Taxable event	Taxable income or wealth	Purchase / sale / Manufacture / Import of goods and provision of services.
Course of payment	Taxpayers directly pays it to government	Taxpayers pays it to government through an intermediary.
Rate of Tax	Based on income or profit the rate of tax will be imposed.	The rate of tax will be same for all taxpayers
Convenience	Tax collection procedure is difficult, and it is inconvenient.	Tax collection procedure is easier and convenient
Power to levy	The power to levy, impose and collect the direct tax will be only on Central government	The power to levy, impose and collect the indirect tax will be shared by Central government and State government.

Administrative costs	The administrative costs associated with direct taxes are significantly higher as compared to those associated with indirect taxes.	The administrative costs associated with indirect taxes are significantly lower as compared to those associated with direct taxes.
Governing Body	Direct taxes are governed and administered by Central Board of Direct Taxes (CBDT)	Indirect taxes are governed and administered by Central Board of Indirect taxes and Customs (CBIC).

Brief history of Indirect Taxation in India

India is a Socialist, Democratic and Republic country. The Constitution of India provides that "no tax shall be levied or collected except by authority". In India the tax system was introduced in ancient times on basis of Manu-Smriti and Arthashastra. During British rule, the entire system was changed.

Following is the historical background of indirect Taxation in India:

- **1860:** Introduction of taxation system in India for the first time by Sir James Wilson.
- **1935:** Government of India Act, 1935 was passed to levy tax on sales of goods on provincial subject. Initially, this Act was adopted by Parliament of United Kingdom.
- **1939:** Sales Tax launched in India in Madras – It is said to be the first Sales Tax Act introduced in Madras in 1939 primarily to compensate the loss in revenue.
- **1941:** Sales Tax launched in Punjab, this Act provides for the levy of general tax on sale or purchase of goods in Punjab.
- **1944:** In 1944, the Central Excise Act was enacted. It was charged on goods manufactured or produced in India. It was introduced by Central Board of Excise and Customs.
- **1974:** In mid of 1970's the Indirect taxation committee headed by L K Jha was appointed. This committee suggested the introduction of Value Added Tax in India.
- **1986:** Based on the recommendations of L K Jha, then Finance Minister Vishwanath Pratap Singh introduced **MODVAT** on selected commodities. Few years later, former Finance Minister Manmohan Singh who is also known as architect of economic reforms took it forward. They extended MODVAT to almost all commodities and reduced Excise Duty rates.

- **1991:** The Government appointed a tax reform committee headed by Prof. Raja Chellaiah to lay out agenda for reforming India's tax system. This Committee came with 3 reports in 1991, 1992 and 1993. One of the major recommendations was simplifying the excise duties and its integration with VAT.
- **1994:** Introduction of Service Tax, it is a tax levied on the transaction of services specified by Central Government under Finance Act, 1944.
- **1999:** Centre (then Finance Minister, Yashwanth Sinha) announced decision to introduce Value Added Tax in India. Introduction of VAT was considered as to be a major step and an essential breakthrough in the field of indirect taxes.
- **2002:** CENVAT was introduced at Central level. This was introduced to provide credit on duty paid on inputs and capital goods and for service tax on input services.
- **2003:** Making a pitch for Haryana as an investment destination state, then State Finance Minister Sampat Singh decided to introduce VAT from 1st April 2003.
- **2005:** VAT was introduced in 24 States including Union Territories. Karnataka State Government also introduced VAT in 2005.
- **2006-07:** Proposal for GST was first mooted in the Budget speech for financial year (then, Finance Minister P Chidambaram). The discussion was made with States with this regard.
- **2008:** The Finance Minister during his Budget speech 2007-08 announced that, at his request, the empowered committee of State Finance Ministers has agreed to work with Central Government to prepare roadmap for the introduction of GST from 1st April 2010
- **2009:** Based on the discussion within and between it and with Central Government, the Empowered Committee released its first discussion paper on GST in November 2009. This spelt out the features of the proposed GST and has formed the basis for discussion.
- **2011:** 115th Constitutional Amendment bill was introduced in the Parliament on 22nd March 2011, deals with key transaction taxes in India. The proposed GST bill, inter-alia seeks to introduce articles effecting the introduction of GST and introduction of GST Council. But this bill subsequently failed to introduce GST.
- **2013:** To review the Constitutional Amendment Bill Standing Committee was appointed to provide recommendations and suggestions. In August 2013, Parliamentary Standing Committee submitted

its report. Recommendations of Standing Committee incorporated in the bill. In September 2013 the revised bill was sent to Empowered Committee for consideration.

- **2014:** On 19th December 2014 NDA Government presented the 122nd Constitution Amendment Bill on GST in Lok Sabha.
- **2015:** The Lok Sabha passed the Constitutional Amendment bill on 6th May 2015.
- **2016:** The modified Constitutional Amendment Bill was passed in Rajya Sabha on 3rd August 2016.
- Finally, the bill received the assent of President on 8th September 2016 and became 101st Constitutional Amendment Act, 2016 which paved for introduction of GST.
- On 1st July 2017 GST was implemented as "One Nation One Tax" in whole of India except in Jammu and Kashmir. But by passing SGST Act and Ordinances relating to IGST and CGST promulgated to extend GST to Jammu and Kashmir.

Structure of Indian taxation

Tax structure in India is a three-tier federal structure. The Central Government, State Government and local municipal bodies make up his structure.

Tax Collection bodies

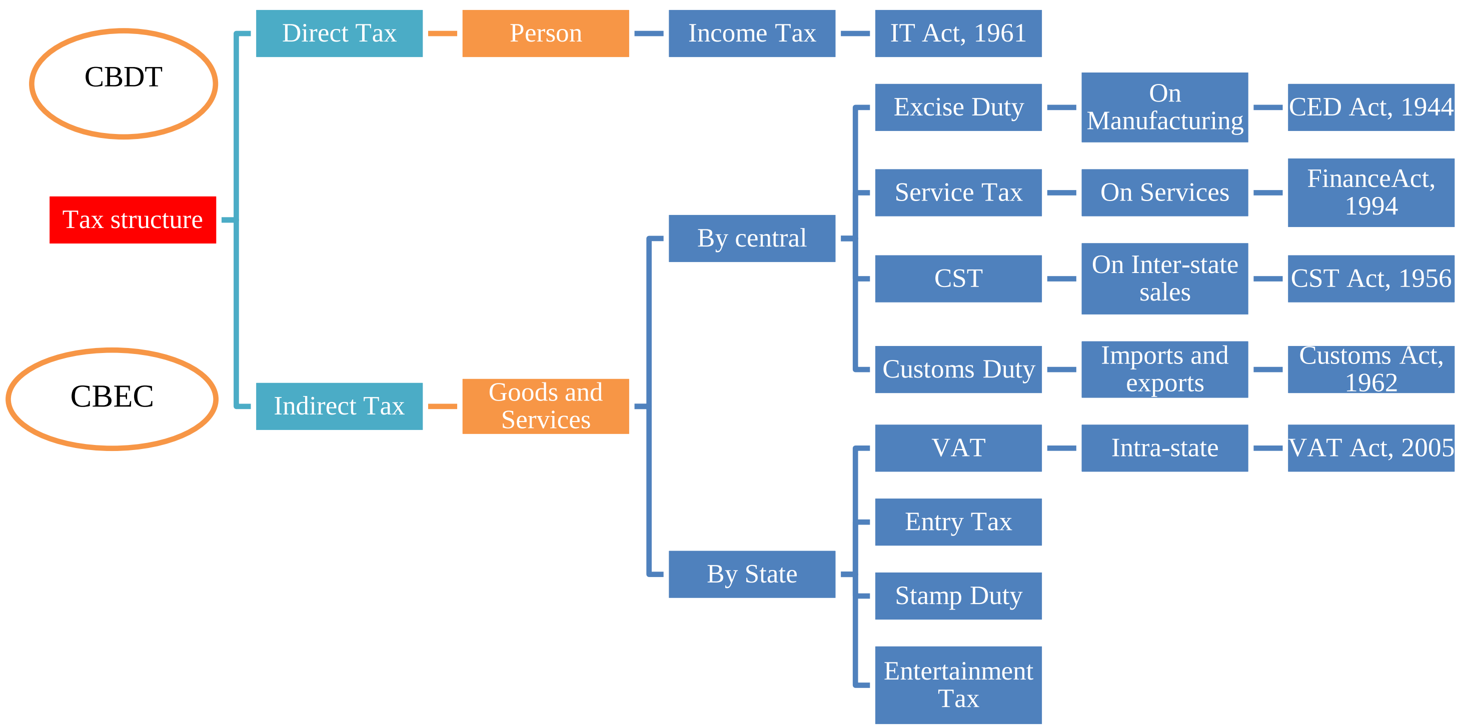
The three bodies which collect the taxes in India are as follows:

- The Central Government: Income Tax, Basic Customs Duty, CGST, IGST etc.,
- The State Government: Professional Tax, Excise duty on alcoholic liquor for human consumption, SGST etc.,
- The Local bodies: Water tax, Electricity tax, Road tax.

The two important articles of the Constitution

Article 246A	• Gives central and state governments the rights to levy and collect the taxes on both goods and services
Article 265	• " No tax shall be levied or collected except by the authority of law"

Structure of Indian Taxation in India before GST



Tax structure before GST can depicted as above.

Indian tax structure was classified into 2 types:

1. **Direct tax:** Direct tax is levied on income of person. Presently Income tax is one of the major and well-known types of Direct tax which governed by Income Tax Act, 1961.
   CBDT: The Central Board of Direct Taxes is a part of revenue department under the Ministry of Finance. It has 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.
2. **Indirect Tax:** Indirect tax was levied on Goods and Services. Before implementation of GST, in India the indirect taxes were levied and collected by Central Government, State Government and local bodies.

The Central Government levied and collected various types of indirect taxes such as,

- **Excise Duty:** It was levied and collected on manufacturing that takes place in inside India and it was governed by Central Excise Act, 1944.
- **Service Tax:** It was levied and collected services provided by an entity or an individual and it was governed by Finance Act, 1994.

- **Central Sales Tax:** It is a tax on sales of goods levied Central Government. Central Sales Tax is levied on sales made in case of inter-state sales only. It was governed by Central Sales Tax Act, 1956.
- **Customs Duty:** It is a tax levied on imports into and exports from India. It is governed by Customs Act, 1962.

The taxes which are levied and collected by State Government,

- **Value Added Tax:** It is a tax collected on intra-state supply of goods. This tax was levied on commodity whenever it adds value at any point in the supply chain, from production to sale. It was governed by Karnataka State VAT Act, 2005.
- **Entry Tax**: It is a tax on the movement of goods from one state to another. It is levied by recipient state to protect its tax base.
- **Stamp Duty:** It is levied by State Governments on the transfer immovable property located in their state. It is also levied on all legal documents.
- **Entertainment Tax**: Entertainment tax is levied by state on every financial transaction that is related to entertainment and is reserved primarily for the state Government.

CBEC: The Central Board of Excise and Customs deals with policy formulation with regards to levy and collection of Customs and Central Excise Duties

<u>The present tax structure in India is classified into 2 types</u>

1. **Direct tax:** Direct tax is levied on income of person. Presently Income tax is one of the major and well-known types of Direct tax which governed by Income Tax Act, 1961.

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1. **Indirect Tax:** The tax system in India for long was a complex one considering the length and breadth of India. Post GST implementation, which was the biggest tax reforms in India, the process has become smoother. It serves as an all-inclusive indirect tax which has helped in eradicating the cascading effect of tax as a whole. It is simpler in nature and has led to upgraded productivity of logistics. Presently, the indirect structure is as follows:

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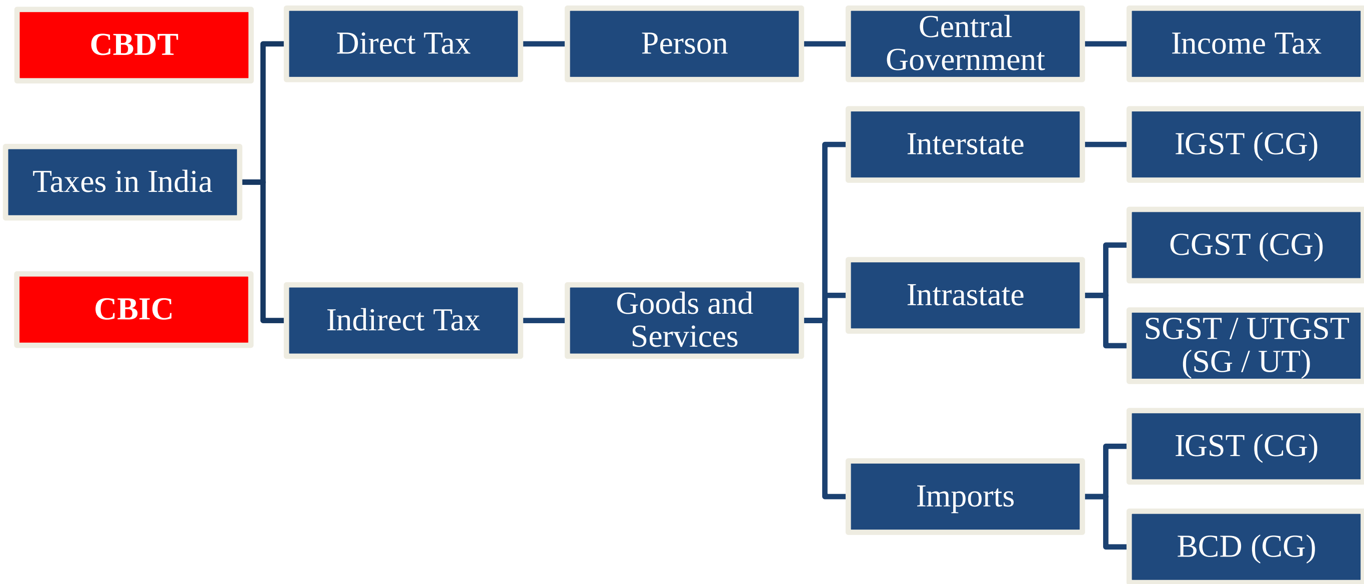
Present Tax Structure in India



- **Inter-State transactions:** On the transactions that takes place between two states, IGST (Integrated Goods and Services Tax) is levied and collected by Central Government.
- **Intra-State transactions:** On the transactions that takes place within the state, CGST (Central Goods and Services Tax) and SGST (State Goods and Services Tax) will be levied. On the transactions that takes place within the boundaries of Union Territories, CGST (Central Goods and Services Tax) and UTGST (Union Territories Goods and Services Tax) will be levied.
- **Imports:** On the imports Basic Customs Duty and IGST will be levied and collected by Central Government.

The taxes such as stamp duty, Municipal Tax, Toll, Road Tax, Excise on Alcohol for human consumption and petroleum products etc., are not bought into the purview of GST.

CBIC: Post GST implementation, CBEC has been renamed as the Central Board of Indirect taxes and Customs (CBIC). The main role of CBIC is assisting the government in policy-making matters related to GST (including other indirect taxes) and Customs duty. With CBIC, GST Council will be having a power to recommend on the issues relating to GST.

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Assignment – 1

Section A

1. What is a Tax?
2. State the meaning of Direct tax and Indirect tax.
3. State the provisions of Article 246A and Article 265.
4. What do you mean by Basic Customs Duty?
5. List out the taxes that are not subsumed under GST.

Section B

1. Explain the advantages and disadvantages of Direct taxes?
2. Enumerate the advantages and disadvantages of Indirect taxes.

Section C

1. Differentiate between Direct tax and Indirect tax.
2. Explain the different types of taxes in India.
3. Write a note on tax structure of India before and after implementation of GST.