

# BACK GROUND OF INDIAN TAX SYSTEM

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## ABSTRACT:

The world's 12th-largest economy at market exchange rates and the fourth largest in purchasing power, India has a quasi-federal form of government. India's Constitution is the longest and the most exhaustive constitution of any independent nation in the world. India has a three-tier federal structure, comprised of the union or central government, the state governments, and the local bodies, all of which have the authority to levy taxes. Besides direct taxes such as the income tax, indirect forms of tax are collected such as the sales tax, VAT, service tax, stamp duty, customs, and excise duty.

## INTRODUCTION

Tax is a fee charged by a Government on a product, income or activity. If tax is levied directly on personal or corporate income, then it is a direct tax. If tax is levied on the price of a good or service, then it is called an indirect tax. The purpose of taxation is to finance public goods and services, such as street lighting, street cleaning, road, dams, utility services etc. Since public goods and services do not allow a non-payer to be excluded, or allow exclusion by a consumer, there cannot be a market in the goods or services, and so they need to be provided by the Government or a quasi- Government agency, which tend to finance themselves largely through taxes.

The word tax is derived from the Latin word 'taxare' which means 'to estimate'. "A tax is not a voluntary payment or donation, but an enforced contribution, exactly pursuant to legislative authority" and is any contribution imposed by Government whether under the name of toll, tribute, impost, duty, custom, Excise, subsidy, aid, supply, or other name." (*Black's Law Dictionary*)

In India, the tradition of taxation has been in force from ancient times. It finds its references in many ancient books like 'Manu Smriti' and 'Arthashastra' "A comprehensive VAT widens tax net, as it makes tax evasion difficult. Going by the experience of other countries, VAT has proved beneficial and leads to revenue buoyancy."

*India can be globally competitive as a fully integrated market in the Value Added Tax regime."*

**- Raja Chelliah, the architect of the VAT system in India.**

Introduction of VAT by Indian States has been hailed as one of the biggest tax reforms in several decades. The Empowered Committee (EC) of State Finance Ministers was the Central body which coordinated the design and implementation of VAT. Currently, all Indian States have implemented VAT and the transition to VAT has been fairly smooth.

The main motive of VAT has been the rationalization of overall tax burden and reduction in general price level. Thus, it seeks to help common people, traders, industrialists as well as the Government. It is indeed a move towards more efficiency, equal competition and fairness in the taxation system. The main benefits of implementation of VAT are:-

Minimizes tax evasion as VAT is imposed on the basis of invoice/ bill at each stage, so tax evaded at first stage gets caught at the next stage;

- A set-off is given for input tax as well as tax paid on previous purchases;
- Abolishes multiplicity of taxes, that is, taxes such as turnover tax, surcharge on Sales tax, additional surcharge, etc. are being abolished;
- Replaces the existing system of inspection by a system of built-in self-assessment of VAT liability by the dealers and manufacturers (in terms of submission of returns upon setting off the tax credit);
- Tax structure becomes simpler and more transparent;
- Improves tax compliance;
- Generates higher revenue growth;
- Promotes competitiveness of exports; etc.

### **NEED FOR THE STUDY**

VAT has been implemented in good spirit. The Centre has started to compensate the States for their revenue losses. It was really tough for the Centre to implement VAT in different States as most of the States were purely dependent on the grants from the Centre. Though, there were opposition from many State Governments, it was possible for the Centre to implement VAT. VAT is a step towards the implementation of GST. GST is a comprehensive structure of both goods and services. It is perceived by the general public that VAT is necessary to curb tax evasion and to contribute to the National exchequer sizeable revenue.

This study analyzes the main reason for tax evasion by the traders, and the general public on VAT system. VAT compels the traders to maintain books of accounts and regular filing of returns. In this scenario, it is necessary to know the extent of difficulties undergone due to the implementation of VAT. Puducherry being a small State depends on the Centre for its main source of revenue. It has to generate more revenue out of its own resources. So, it necessary to know how the revenue of this State has increased or decreased due to the implementation of VAT. This study reviews the administrative difficulties of the tax department undergoes in administering VAT and its preparedness and expectations under the proposed GST. Also, study attempts to know the expectations of the traders in the forthcoming GST scenario. More than 150 countries in the world have been experiencing the VAT/GST regime. India is now moving towards GST to be rolled out in April/Oct 2012. Hence, this study is very relevant in India in the especially Puducherry context of transition from erstwhile tax regime to VAT and further GST.

### **SCOPE OF THE STUDY**

The study was conducted to analyze the effectiveness of implementing VAT. It covered the opinions of the professionals, traders, manufacturers and the general public, consumers. It brought to light the beneficial impacts of VAT. This study emphasizes the reason for transition from VAT to GST. This study was conducted with regard to the State of Puducherry which includes Karaikal, Mahe and Yanam regions.

### **SIGNIFICANCE OF THE STUDY**

VAT is the most important tax revenue for States, contributing more than one-half of their own tax receipts. It is expected to bring down the incidence of harassment and corruption that trade and industry encounter. The introduction of VAT has brought great apprehensions in the minds of many and the same will be passed on to the consumers. There was fear among the contributors of tax that the cost of goods might go up, harassment would be more and so on. VAT was introduced in Puducherry in the year 2007. The VAT will not provide full set off for input tax but also abolish the burden of several existing taxes viz, turnover tax, surcharge on Sales tax, additional surcharge, special additional tax etc.

The State level VAT will be self-policing, improving tax compliance and reducing prices and all these will increase tax buoyancy. This study is an attempt to examine the pre and post VAT regime and, the pros and cons of old as well as the new system. It is very important in this context to find out the possibility, practicability and prospects and constraints of the transition from VAT to GST (Goods and Service tax). This study is very relevant in the context of the administration of VAT in India with special reference to Puducherry State. Puducherry is being a Union Territory with little scope for increasing tax revenues which hitherto setting more of Central funds. Now, the State is forced to raise more funds (OTRs) to get an equated Central fund. Hence this study assumes greater significance.

### **OBJECTIVES OF THE STUDY**

The present study is carried out with the following objectives:

- To study various aspects of VAT system in India and to analyze the aspects of VAT system in developed countries.
- To examine responses from the experts regarding implementation and administration of VAT in Puducherry State.
- To elicit the opinion of traders (business men) relating to their perception about VAT in Puducherry State.
- To evaluate the opinion of General Public regarding the VAT in Puducherry State.
- To analyze the current Sales tax form and its impact in the administration of VAT.

### **LIMITATIONS OF THE STUDY**

- The inherent weakness of primary source of data applies to this research study only.
- The inadequate knowledge of the respondents about VAT policies, procedures and methods likely to affect the response of general public.
- The samples and the data collection are based on the willingness and reactions of the respondents.
- The process of administration of VAT is an ongoing process and the inference and conclusions based on collected information may not reflect the future course of action.
- As the reforms are continuous in nature, the findings of the study in the right of evaluation of data may change from time to time.

### **INDIAN TAX SYSTEM BACKGROUND**

#### **TAXATION IN INDIA**

The world's 12th-largest economy at market exchange rates and the fourth largest in purchasing power, India has a quasi-federal form of government. India's Constitution is the longest and the most exhaustive constitution of any independent nation in the world. India has a three-tier federal structure, comprised of the union or central government, the state governments, and the local bodies, all of which have the authority to levy taxes. Besides direct taxes such as the income tax, indirect forms of tax are collected such as the sales tax, VAT, service tax, stamp duty, customs, and excise duty.

#### **INCOME TAX ACT — BACKGROUND**

Historians have argued that modern ideas and institutions of law, medicine, and criminal justice were first tested in the colonies and later implemented in metropolitan areas.<sup>2</sup> The tax system was first introduced in India during the British rule. Today, the Income Tax Act, 1961 (Act 43 of 1961) — the primary legislation dealing with taxability of income — is self-contained legislation. The Income Tax Act empowers the Central Board of Direct Taxes to formulate rules for implementing the provisions of the ITA.<sup>3</sup> Income tax is a tax payable under section 139 of the ITA by filing a return (form/declaration) of income,<sup>4</sup> at the rate enacted by the Union Budget (Finance Act) for every year on the total income earned in the previous year by every person (individual or company) who is a resident, nonresident, or resident who is not ordinarily resident. Residents are taxable for all their income, including income arising outside India.

The division of tax and expenditure powers is spelled out in the constitution. Article 366(29) defines tax on income as including tax in the nature of an excess profits tax.

Thus, the Indian Parliament has the exclusive power to levy a tax on income other than agricultural income. The Indian Parliament also has the power to make laws regarding any other matters not enumerated, including any tax not mentioned. While agriculture plays a dominant role in the economy, a government task force recommended that agricultural income be taxed.

The share of revenue generated from agriculture has been declining while the IT and outsourcing services sector has become a major catalyst for the Indian economy given its effects on income generation and job creation.

Any Government gets its revenue for expenditure purpose from three different sources i.e. income from taxes, income from services rendered to the general public and various grants and contributions received from foreign countries and international organizations. Mostly each and every government collects its major revenue by way of taxes, which is a compulsory charge imposed by the government without rendering any service to tax-payer. By taking into account on whom the money burden of the tax will fall, the taxes are classified into direct tax i.e. taxes on income received and indirect taxes i.e. taxes on expenditure incurred.

Income-tax i.e. tax on all types of income received by an individual in a given period comes under the direct tax segment which has proved to be the major source of revenue to the government of majority of the countries in the world and an ideal tax from the point of view of equity. In India, income-tax contributes up to 57.72% to the total revenue of the central government. It is levied under Income-Tax Act, 1961. The tax rates change according to financial bill passed by the Central Government in each year in its budgetary session. Though income-tax is one of the important sources to the government finance, it is an evil to tax-payer. Because of compulsion element, each tax-payer faces the problem of how to find golden means between minimizing tax liability and maximizing their savings. In this context, tax consultants who are professionals in the areas help them by way advising on tax matters as well as finalizing their tax proposals by charging certain fees in the form of service charges. They also provide some other ancillary services on demand of customers by charging separately for it.

**STATEMENT OF THE PROBLEM :**

Income-tax which is one of the major direct taxes has got much importance due to rising level of income in the recent years. In last few decades the number of income-tax consultants as well as income-tax payers has been increased by many folds. Though the relation between tax consultants and tax-payers is cordial, there are some difficulties on both the sides in maintaining cordial relationship. Tax consultants have formed their associations, which deal with their problems. Tax-payers do not form such types of associations. They deal with their difficulties on individual levels. It is seen that the cordial relationship between the two has been hampering due to these difficulties in recent years.

As such, the researcher decided to study the problem under the title of '**A Critical Study of the Services Provided by the Income-Tax Consultants to the Selected Individual, Firm and Company Assesseees in the Sangli- Miraj-Kupwad Corporation Area.**'

Taxes in India are levied by the Central Government and the state governments. Some minor taxes are also levied by the local authorities such as the Municipality.

The authority to levy a tax is derived from the Constitution of India which allocates the power to levy various taxes between the Central and the State. An important restriction on this power is Article 265 of the Constitution which states that "No tax shall be levied or collected except by the authority of law". Therefore, each tax levied or collected has to be backed by an accompanying law, passed either by the Parliament or the State Legislature. In 2015-2016, the gross tax collection of the Centre amounted to ₹14.60 trillion (US\$220 billion).

**HISTORY:**

India has abolished multiple taxes with passage of time and imposed new ones. Few of such taxes include inheritance tax, interest tax, gift tax, wealth tax, etc. Wealth Tax Act, 1957 was repealed in the year 2015.

Direct Taxes in India were governed by two major legislations, Income Tax Act, 1961 and Wealth Tax Act, 1957. A new legislation, Direct Taxes Code (DTC), was proposed to replace the two acts. However, the Wealth Tax Act was repealed in 2015 and the idea of DTC was dropped.

## SERVICE TAX:

It is a tax levied on services provided in India, except the State of Jammu and Kashmir. The responsibility of collecting the tax lies with the Central Board of Excise and Customs(CBEC). From 2012, service tax is imposed on all services, except those which are specifically exempted under law(e.g. Exempt under Negative List, Exempt as exclusion from Service definition as per Service Tax, Exempt under MEN(Mega exemption notification)). In budget presented for 2008- 2009, it was announced that all small service providers whose turnover does not exceed ₹10 lakh (US\$15,000) need not pay service tax.

Service tax at a rate of 14 percent(Inclusive of EC & SHEC) will be imposed on all applicable services from 1 June 2015.From 15th November 2015, Swachh Bharat cess of 0.5% has been added to all taxable service leading the new Service Tax rate to be 14.5 percent (Inclusive of EC, SHEC & Swachh Bharat cess). On 29 February 2016, Current Finance Minister Mr. Arun Jaitley announces a new Cess, Krishi Kalyan Cess that would be levied from the 1st June 2016 at the rate of 0.5% on all taxable services. The purpose of introducing Krishi Kalyan Cess is to improve agriculture activities and welfare of Indian farmers. Thus, the new Service Tax rate would be 15% incorporating EC, SHEC, Swachh Bharat Cess and Krishi Kalyan Cess. From 2015 to currently, the gross tax collection of the Centre from service tax has amounted in excess of ₹2.10 trillion (US\$32 billion).

## CENTRAL EXCISE



**Logo of Customs and Central Excise**

In 2015-2016, the gross tax collection of the Centre from excise amounted to ₹2.80 trillion (US\$43 billion).

1. **Central Excise Act, 1944**, which imposes a duty of excise on goods manufactured or produced in India;
2. **Central Sales Tax, 1956**, which imposes sales tax on goods sold in inter-state trade or commerce in Indisale of property situated within the state<sup>[12]</sup>

In the 2016 Union budget of India, an excise of duty of 1% without input tax credit and 12.5% with input tax credit was imposed on articles of jewellery with the exception of silver jewellery. The government had earlier proposed an excise duty in the Budget 2011-12, which had to be rolled back after massive protests by jewellers.

- Central Excise Tariff Act, 1985
- Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000.

### **CONSTITUTIONALLY ESTABLISHED SCHEME OF TAXATION:**

Article 246 of the Indian Constitution, distributes legislative powers including taxation, between the Parliament of India and the State Legislature. Schedule VII enumerates these subject matters with the use of three lists:

- List - I entailing the areas on which only the parliament is competent to make laws,
- List - II entailing the areas on which only the state legislature can make laws, and
- List - III listing the areas on which both the Parliament and the State Legislature can make laws upon concurrently.

Separate heads of taxation are no head of taxation in the Concurrent List (Union and the States have no concurrent power of taxation). The list of thirteen Union heads of taxation and the list of nineteen State heads are given below:

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