International Journal of Humanities and Social Science Research
ISSN: 2455-2070; Impact Factor: RJIF 5.22
www.socialsciencejournal.in
Volume 3; Issue 5; May 2017; Page No. 65-69

Indian Tax Structure

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Abstract

The development of any countries economy largely depends on the tax structure. India has a well developed tax structure with clearly demarcated authority between Central and State Governments and local bodies. Indian Taxation system has undergone tremendous reforms during the last decade. The tax rates have been rationalized and tax laws have been simplified resulting in better compliance, ease of tax and better reinforcement. The power to levy taxes and duties is distributed among the three tier government- centre, state and local. This paper also discusses GST impact on economy and how the introduction of goods and services tax in India is now on horizon.

Keywords: taxation, structure, GST, levy, economy, direct taxes, indirect taxes, tax structure of India, taxation, tax collection

Introduction

India has a well-structured tax system. Taxes are the largest sources of revenue for the government. Taxes are determined by the centre and state government along with local authorities like municipal corporations. The government cannot impose any tax unless it we passed as a law. The main taxes/duties that the centre government is empowered to levy are income tax, custom duties, centre excise and sales tax service tax. The principal Taxes levied by the state government are sales taxes stamp duty, lend revenue, tax on agricultural income. The local bodies are empowered to levy taxes on properties, octroi, tax on markets and tax/user charges for utilities like water supply. There are two types of taxes: direct taxes and indirect taxes. In case of direct taxes the burden directly falls on the tax payers. These are those taxes which can be transferred to others by the tax payers. These types of taxes are income tax, corporate tax, wealth tax. Indirect taxes are those taxes which can be transferred on the others by the tax payers. These types of taxes are sales tax, central sales tax. The tax rates have been rationalized and tax laws have simplified resulting in better compliance, ease of tax payment and better enforcement. The process of rationalization of tax administration is ongoing in India.

Salient Features of Indian Tax Structure

Indian tax structure, like in any other country, has developed in response to many influences social, political and economic.

1. **1 The Scientific Division of Tax Powers:** India being a federation there is the existence of a multilevel finance system. The constitution of India forms, the basis of division of powers into union based on their constitution has made q provision for division of tax powers between state and centre. The area and sphere of taxation of centre and state is clearly demarcated as per constitutional provision. Taxes which is in the purview of central government accounted 50% of its revenue. Some taxes are again levied by the central government and the proceeds of such taxes are divided between the centre and state Government.
2. **Multiplicity of Tax Structure:** India is having a broad based and extensive tax structure, its main feature is the existence of multiplicity of taxes. There are both union government taxes and state government taxes. The tax structure includes both direct and indirect taxes. Indirect taxes play a dominant role in the composition of tax revenue. Among the direct tax imposed in India, the most important income tax. Other prominent taxes are wealth tax, capital gains tax and gift tax etc. The indirect tax in India consists of excise duties, custom duties. The taxes levied by the union government are income tax, wealth tax, gift tax, custom duties etc.
3. **Larger share of Indirect Taxes:** In India, in the total tax revenue there is the domination of indirect taxes over direct taxes. Indirect taxes shared 63% in 1950-1951 where it increased to 77% in 2001-02. It shows that because of the underdeveloped character of the economy and glaring inequalities in income, the income, the scope of direct taxes is limited.
4. **Insufficient Tax Revenue:** In spite of rising trends in tax revenue, the total revenue remained small when compared to developed countries. The tax GDP ratio generally remained in the range of 8% to 9% in India in 2005-2006 survey where it is high in countries like Sweden, France, USA, UK etc where it is range between 30 to 40%.
5. **Incidence of Taxation:** In India the incidence of taxation is higher in urban areas that in rural area that is because of the predominance of agriculture in rural areas and income of households. The urban population depends more on service and business sector and enjoy higher income tax paying capacity.
6. **Progressiveness in Tax Structure:** India tax structure is framed in India such a way that all indices of ability to pay is taxed. The direct tax is framed in such a way that as tax base increases, tax rates also rises sharply. Excise duties are levied and collected discriminately depending on the type of commodity and class of commodities.

Background of Taxation in India

The word of tax is from Taxation which means an estimate. Tax is a mandatory liability for every citizen of the country.

There is two types of taxes India direct and indirect tax. Taxation in India is rooted from the period of Manu Smriti and Arthasastra. Present law system was based on the theory of maximum social welfare.

Initial Period (1860-1886)

In India income tax was introduced for the first time in 1860, by sir James Wilison in order to meet the losses sustained by the government on account of military mutiny of 1857. Thereafter several amendments were made in it from time to time. In 1886 a separate income tax act was passed

Pre-Independence Period (1886-1947)

In 1918 a new act new income tax act was passed with great improvement than the previous acts. In 1921 the government constituted all India income tax committee. In this period the board of revenue and income tax department with defined administrative structure came into existence the organizational history of the Income-tax Department starts in the year 1922. The Income-tax Act, 1922, gave, for the first time, a specific nomenclature to various Income-tax authorities. The foundation of a proper system of administration was thus laid. In 1924, Central Board of Revenue Act constituted the Board as a statutory body with functional responsibilities for the administration of the Income-tax Act. Commissioners of Income- tax were appointed separately for each province and Assistant Commissioners and Income-tax Officers were provided under their control. The amendments to the Income tax Act, in 1939, made two vital structural changes: (i) appellate functions were separated from administrative functions; a class of officers, known as Appellate Assistant Commissioners, thus came into existence, and (ii) a central charge was created in Bombay. In 1940, with a view to exercising effective control over the progress and inspection of the work of Income-tax Department throughout India, the very first attached office of the Board, called Directorate of Inspection (Income Tax) - was created. As a result of separation of executive and judicial functions, in 1941, the Appellate Tribunal came into existence. In the same year, a central charge was created in Calcutta also

Post-Independence Period

In 1956, Government of India referred it to the law commission in 1956 with a view to simplify and prevent the tax evasion. The tax commission submitted its report in 1958 regarding income tax act. In this mean time Government of India. Appointed the direct tax administration enquiry committee submitted its report and finally with the consultation of the income tax act 1961 was passed. In come into force 1 April 1962. It is comprehensive piece of legislation having 23 chapters, 298 sections and 14 schedules. It applies whole of the India [except Jammu and Kashmir] the developing nature of the economy of the country brought with it both steep rates of taxes and black incomes. In 1965, the Voluntary Disclosure Scheme was brought in followed by the 1975 Disclosure Scheme. Finally, the need for a permanent settlement mechanism resulted in the creation of the Settlement Commission. A very important administrative change occurred during this period. The recovery of arrears of tax which till 1970 was the function of State authorities was passed on to the departmental officers. A whole new wing of Officers - Tax Recovery Officers was created and a new cadre of post of Tax Recovery Commissioners was introduced w.e.f. 1-1-1972. In order to improve the quality of work, in 1977, a new cadre known as IAC (Assessment) and in 1978 another cadre known as CIT (Appeals) was created. The Commissioners' cadre was further reorganized and five posts of Chief Commissioners (Administration) were created in 1981. During the early post independence period, the income tax legislation had become very complicated on account of innumerable changes. During this period tax evasion was wide spread and tax collection was very expensive. Several amendments have been made in income tax act by union budget, every year which also contain in finance bill. After it is passed by the Houses of parliament and receive the accent of the president of India it become finance act. Further various amendments have been made in 1987 and direct tax law (second amendment) in 1992 and 1993 on the recommendations of Chellian committee.

Tax Reforms in India

There have been major changes in tax systems in several countries over the last two decades for a variety of reasons. The objective of this paper into analyzes the evolution of the tax system in India since the early 1990 s. The paper describes and assesses the introduction of new forms of direct and indirect taxes, their revenue and equity implications and the successes Achieved in their implementation. The paper concludes that after eight Years of reform improving the tax system remains a major challenge in India. There have been major changes in tax systems of countries with a wide Variety of economic systems and levels of development during the last two decades. The motivation for these reforms has varied from one country to another and the Thrust of reforms has differed from time to time depending on the development strategy and philosophy of the times. In many developing countries, the immediate reason for tax reforms, has been the need to enhance revenues to meet impending fiscal crises. As Bird (1993) states, "…fiscal crisis has been proven to be the mother of tax reform". Such reforms, however, are often ad hoc and are done to meet immediate exigencies of revenue. In most cases, such reforms are not in the nature of systemic improvements to enhance the long run productivity of the tax system. One of the most important reasons for recent tax reforms in many developing and transitional economies has been to evolve a tax system to meet the requirements of international competition (Rao 1992). The transition from a predominantly centrally planned development strategy to market based resource allocation has changed the Perspective of the role of the state in development. The transition from a public sector based, heavy industry dominated, import substituting industrialization strategy to one of allocating resources according to market signals has necessitated systemic changes in the tax system. In an export-led open economy, the tax system should not only raise the necessary revenues to provide the social and physical infrastructure but also minimize distortions. Thus, the tax system has to adjust to the requirements of market economy to ensure international competitiveness. The philosophy of tax reform has undergone significant changes over the years in keeping with the changing perception of the role of the state. With the change in the development strategy in favour of market determined resource allocation, the traditional approach of raising revenues to finance a large public sector without much regard to economic effects has been given up. The recent approaches to reform lay emphasis on minimizing distortions in tax policy to keep the economy competitive. Minimizing distortions implies reducing the marginal rates of both direct and indirect taxes. This also calls for reducing differentiation in tax rates to reduce unintended distortions in relative prices. To achieve this, the approach suggests broadening of the tax bases. Thus, over the years, emphasis has shifted from vertical equity in which both direct and indirect taxes are subject to high marginal rates with minute differentiation in rates, to horizontal equity in which, the taxes are broad-based, simple and transparent, and subject to low and less differentiated rates. Equity in general, is taken to mean improving the living conditions of the poor. This has to be achieved mainly through expenditure policy and human resource development rather than reducing the incomes of the rich as was envisaged in the 1950 s and 1960 s. Conventional wisdom on tax reforms provides us with at least three different model of tax reform. The optimal tax (OT) model (Ahmad and Stern 1991) is satisfactory in terms of its theoretical soundness, but has been found to be impractical in its applications. Besides the trade-off between efficiency and equity in tax policy, the information and administrative costs of designing an optimal tax model have been found to be prohibitive and, therefore, as a practical guide to tax policy this has not been useful. The Harberger tax model (HT) like the OT model is well grounded in theory. It, however, draws much more on practical experience. According to this, while efficiency (and distribution weights) is clearly desirable in the design of tax policy, administrative capability is equally, if not more, important. The principal concern, according to this approach, is not to design a system that will be optimal, but emphasis the system that will minimize tax-induced distortions and at the same time be administratively feasible and politically acceptable. In fact, Harberger suggests that tax reformers should pay less attention to the economic methodology and more to best practice experiences. The basic HT reform package for developing countries that are price takers in the international market consists of, inter alia; a uniform tariff ana broad-based VAT (value-added tax).The third is the supply-side tax model (SST). This model emphasizes the need to reduce the role of the state. Reduction in the volume of public expenditures has to be achieved by cutting the tax rates, particularly the direct tax rates to minimize disincentives on work, saving and investment. The proponents of this model emphasis the need to broaden the base with minimal exemptions and preferences and to have low marginal tax rates. Again emphasis is on minimizing distortions in relative prices and, therefore, the approach emphasizes less rate differentiation. The recent reform approaches combine elements of all three models sketched above. This incorporates both theory and past reform experiences and takes into account administrative, political and information constraints in designing and implementing reforms. The thrust of this approach is to enhance the revenue productivity of the tax system while minimizing relative price distortions. The best practice approach has attempted to make the tax systems comprehensive, simple and transparent. As mentioned earlier, the general pattern of these reforms has been to broaden the base of taxes, reduce the tax rates and lower the rate differentiation both in direct and indirect taxes. A broader base requires lower rates to be levied to generate a given amount of revenues. Lower marginal rates not only reduce disincentives to work, save and invest, but also help to improve tax compliance. More importantly, broadening the tax base helps to ensure horizontal equity, is desirable from the political economy point of view as it reduces the influence of special interest groups on tax policy, and reduces administrative costs. In the case of indirect taxation, the reform agenda includes the levy of abroad-based VAT with minimal exemptions and supplemented by a few luxury excises. As regards import duties, quantitative restrictions should be replaced by tariffs, export taxes eliminated, and dispersion in tariffs should be minimized. Personal income tax too is to be levied on all but a small number of persons with income levels less than twice the per capita income of the country. Much of the direct taxes should be collected by withholding, but for the "hard-to-tax" groups, presumptive taxation is tobe applied. Emphasis on horizontal equity also implies emphasis on strengthening administration and enforcement of the tax and the development of proper information systems and automation. The philosophy of tax reform has undergone significant changes over the years in keeping with the changing perception of the role of the state. With the change in the development strategy in favour of market determined resource allocation, the traditional approach of raising revenues to finance a large public sector without much regard to economic effects has been given up. The recent approaches to reform lay emphasis on minimizing distortions in tax policy to keep the economy competitive. Minimizing distortions implies reducing the marginal rates of both direct and indirect taxes. 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Effect of Tax structure on Economic Growth

Higher the corporate tax rates should decrease economic growth rates one of the major source of Government. The government collected taxes in order to carry out various activities that would better the livelihood of their citizens by attaining long-term economic growth. Attaining long term growth is one of the major macroeconomic goal of most government all over the world, by using taxes as a tools to stimulate long -term growth, it is important to know which taxes components should be targeted. In India, it is very important because fiscal challenges in the form of deficits have necessitated various reforms which include the fiscal responsibility and budget management act 2003. Which had reducing revenue deficit by 0.5% of GDP annually? As of its target with full elimination to be attained in 2008-9. By targeting the elimination of revenue deficit in order to achieve long term growth it is very essential to know which revenue should be targeted. High taxes can be seemed to be negative for investment, employment and economic growth. Poirson contends that the increase in VAT to have a positive effect on economic growth and on the other hand it is revealed that there is an inverse relationship between corporate and personal taxes and economic growth. In 2006 it is revealed that recent reforms in India would improve tax productivity and decrease the marginal tax burden and also state that goods and service tax would helpful to GDP growth by more than 2% in Indian.

GST Impact on Indian Economy

The introduction of goods and services tax in India is now on horizon. The constitution amendment bill to replace existing multiple indirect taxes by uniform GST across India. The need for GST has been felt because of under the current indirect tax structure:

- Tax barriers have fragmented the Indian market.
- Cascading effect of taxes on cost has made indigenous manufacture less attractive.
- Complex multiple taxes have raised cost of compliance.

The GST council has finalized a four tier tax structure of 5%, 12%, 18% and 28% with lower rates for essential items, highest for luxury goods and de-merits goods, including luxury cars and tobacco products. With a view to keeping half of the consumer inflation basket, will be taxed at zero rate. GST expertly to have a these favorable outcome of the economy.

- Removal of Tax barriers with seamless credit will make India a common market leading to economies of scale in production and efficiency in supply chain.
- Removal of cascading effect of taxes embedding in cost of production of goods and services significantly reducing cost of indigenous goods and indirectly promoting make in India.
- Facilitating ease of doing business. Integration of multiple taxes into single GST that lead to reduction in transaction cost.
- Stable, transparent and predictable tax regimes to encourage local and foreign investment in India creating significant job opportunities.

Impacts of GST

1. Reduce tax burden on producers and foster growth through more production. GST provide tax credit to manufacturer.
2. Tax barrier, check post, toll plazas, lead to wastage of unpreserved items being transported. This penalty transform into major cost to higher needs of buffer stock and warehouse and cost. A single taxation system will eliminate their road block.
3. There will be transparency in the system, as the customers will know exactly how much taxes they are being charged on what base.
4. GST will add to the government revenues by extending tax rates.
5. GST will remove the custom duties impose on exports. The nation’s competitiveness in foreign market will increase on account of lower cost of production.

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