Sources of Revenue - Taxation

- Taxation is a term for when a taxing Authority, usually a government, levies or imposes a tax.
- The term 'taxation' applies to all types of involuntary levies, from income to Capital gains to estate taxes.
- Though taxation can be a noun or verb, it is usually referred to as an Act;
- The resulting revenue is usually called 'taxes'.

Taxes:

- Taxes are compulsory payments to the Government without expectations of direct or return or benefit to the taxpayers.
- According to Prof. Seligman, taxes are defined as a Compulsory contribution from a person to the Government to defray the expenses incurred in the common interest of all without reference to Special benefits conferred.

Taxes Imposed:

- Everybody is obliged by law to pay taxes.
- Total Tax money goes to government exchequer.
- The government decides how are taxes to be spent and how the budget is to be organized.
- Tax Payment is not optional.
- An individual has to pay tax if any income comes under the income Tax slab.
- It is a duty of every citizen to pay taxes.
- More collection of tax allows the government to implement more and more welfare schemes.

Principle of taxation:

- Adam Smith's principles or cannons of taxation still form the basis of the tax structure of a Modern state.

Canon of Equality:

- The government should impose taxes in such a way that people have to pay according to their ability.

- It does not mean equal amount of tax but it means that the Burden of a tax must be fair and just.

Canon of Certainty:

- Certainty creates Confidence in the taxpayers cost of collection of Taxes and increases economic welfare because it Tends to avoid all economic waste.

Canon of Convenience:

- Taxes should be levied and collected in such a manner that it provides a maximum of convenience to the Taxpayers.
- It should always be kept in view that the taxpayers suffer the least inconvenience in Payment of the tax.

Canon of Economy:

- Minimum possible Money should be spent in the collection of Taxes.
- Collected amount should be deposited in the government treasury.

Taxation Types:

There are three types of Taxation:

  - Proportional Tax
  - Progressive Tax
  - Regressive Tax

- **Proportional Taxation** is a method, where the rate of tax is same regardless the size of the Income.
- The tax amount realized will vary in the same proportion as that of income.
- If tax rate is 5% on income and Mr. X gets an income of Rs.1,000, he will pay Rs.50, Mr. B gets an income Rs.5,000, he will pay tax of Rs.50.
- In short, proportional tax leaves the relative financial status of taxed persons unchanged.
- **Progressive Taxation** is a method by which the rate of tax will also increase with the Increase of income of the person.
- If a person With Rs.1000 income per annum pays a tax of 10% (i.e) Rs.100, a person with an income of Rs.10,000 per annum pays a tax of 25% (i.e) Rs.2,500 and a person with income of 1 lakh per Annum pays the tax of 50% that is Rs.50,000.

- **Regressive Taxation** is a tax applied uniformly, Taking a larger percentage of income from low Income earners than from high income earners.
- It is in opposition to a progressive tax.

Importance of Tax:

- Without taxes, governments would be unable to meet the demands of their societies.
- Taxes are crucial because governments collect this money and use it to finance under the following social projects.

Health:

- Without taxes, government contributions to the health sector would be impossible.
- Taxes go to funding health services such as social healthcare, medical research, social security, etc

Education:

- Education could be one of the most Deserving recipients of tax money.
- Governments put a lot of importance in the development of Human capital and education is central in this Development.

Governance:

- Governance is a crucial component in the smooth running of country affairs.
- Poor governance would have far reaching Ramifications on the entire country with a Heavy toll on its economic growth.
- Good Governance ensures that the money collected is utilized in a manner that benefits citizens of the country.
- Other important sectors are infrastructure Development, transport, housing, etc.
- A part from social projects, governments also use money collected from taxes to fund Sectors that are crucial for the wellbeing of their citizens such as security, scientific research, Environmental protection, etc.
- Some of the money is also channelled to Fund projects such as pensions, unemployment Benefits, childcare, etc.

- Taxes can affect the state of economic growth of a country.
- Taxes generally Contribute to the gross domestic product (GDP) of a country.

Types of tax:

In modern times taxes are classified into two types. There are:

- Direct Tax
- Indirect Tax

Direct Tax:

- A Direct tax is paid directly by an individual or organisation to imposing entity.
- A tax payer, for example, pays direct taxes to the Government for different purposes, Including real property tax, personal property Tax, income tax or taxes or on asserts.
  - **Corporation Tax:**
    - It is levied on profit of corporations and companies.
    - It is charged on royalties, Interest, gains from sale of capital assets Located in India, fees for technical services and dividends
  - **Wealth Tax:**
    - It is imposed on property of individuals depending upon the value of property.
    - The Same property will be taxed every year on its Current market value.
  - **Gift Tax:**
    - It is paid to the Government by the recipient of gift depending on value of gift.
  - **Estate Duty:**
    - It is charged from successor of inherited Property.
    - It is not desirable to avoid payment of taxes.
    - They are levied directly on income and property of Persons, who pay directly to the government.

Indirect Tax:

- On the other hand, when liability to pay a tax is on one person and the burden of that tax shifts on some other person, this type of tax is called an Indirect tax.
- Indirect Tax is a tax whose burden can be shifted to others.
  - **Service Tax:**
    - It is raised on provision of Service.
    - This tax is collected from the service recipients and paid to the Central Government.
  - **Sales Tax or VAT:**
    - It is an indirect tax on sale of goods because liability to collect tax is that of shopkeeper but the burden of that tax falls on the customer.
    - The shopkeeper realizes the tax amount from the customer by including it in the price of the Commodity that he sells.
  - **Excise Duty:**
    - It is paid by the producer of goods, who recovers it from wholesalers and retailers.
    - This Tax in India is levied by the Central Government.
  - **Entertainment Tax:**
    - The state governments charge such Tax on every transaction related to Entertainment.
    - Some examples are movie tickets, video Game arcades, stage shows, exhibitions, Amusement parks, and sports-related Activities.
  - **Stamp duty:**
    - Stamp duty is a tax that is paid on official Documents like marriage registration or Documents related to a property and in some Contractual agreements.

Goods and Services Tax (GST):

- Goods and Services Tax is a kinds of tax Imposed on sale, manufacturing and usage of goods and services.

- This tax is applied on services and goods at a national Level with a purpose of achieving overall economic growth.
- GST is particularly designed to replace the indirect taxes Imposed on goods and services by the Central and State.
- The goods and service tax (GST) is one of the indirect taxes.
- The GST was passed in Parliament on 29 March 2017.
- The act came into effect on 1 July 2017.
- The motto is one Nation, one market, one tax.
- France was the first country to implement GST in 1954.

Structure of Goods and Service Tax (GST):

- **State Goods and Service Tax (SGST):** Intra state (within the state) VAT/sales tax, purchase tax, entertainment tax, luxury tax, lottery tax and state surcharge and Cesses
- **Central Goods and Service Tax (CGST):** Intra state (within the state) Central Excise Duty, service tax, countervailing duty, additional duty of customs, surcharge, Education and secondary / higher secondary cess
- **Integrated Goods and Service Tax (IGST): Interstate (integrated GST)** There are four major GST rates: (5%, 12%, 18% and 28%) Almost all the necessities of life like vegetables and food grains are exempted from this tax.

Tax Evasion:

- Tax evasion is the illegal evasion of taxes by Individuals, corporations and trusts. Tax evasion Activities included
  - Underreporting income
  - Inflating deductions or expenses
  - Hiding money
  - Hiding interest in offshore accounts

Tax evasion penalties:

- If a person wilfully commits the act of tax Evasion, he may face felony charges.
- Tax evasion penalties include imprisonment of Up to five years and high amount as fines.

- The defendant may also be ordered to pay for the costs of prosecution.
- Tax evasion penalties can be harsh, Depending on the severity of the crime Taxes and Development

The role of taxation in developing Economies is as follows.

Resource mobilisation:

- Taxation enables the government to mobilise a substantial Amount of revenue.
- The tax revenue is generated by imposing direct taxes such as Personal income tax and corporate tax and Indirect taxes such as customs duty, excise Duty, etc.

Reduction inequalities of income:

- Taxation follows the principle of equity.
- The direct taxes are progressive in nature.
- Also, certain indirect taxes, such as taxes on luxury goods, is also progressive in Nature.

Social welfare:

- Taxation generates social Welfare.
- Social welfare is generated due to higher taxes on certain undesirable products like alcoholic products.

Foreign exchange:

- Taxation encourages Exports and restricts imports, Generally Developing countries and even the Developed countries do not impose taxes on export items.

Regional development:

- Taxation plays an important role in regional development, Tax incentives such as tax holidays for Setting up industries in backward regions, which induces business firms to set up Industries in such regions.

Control of inflation:

- Taxation can be used as an instrument for controlling inflation.
- Through taxation the government can Control inflation by reducing the tax on the commodities.

Surcharge

- It is an additional charge on tax.
- Income level above a certain threshold.
- The revenue from the surcharge is kept under the Consolidated Fund of India.
- Not to be shared with states.
- It is levied for extra services or to defray the cost of increased commodity pricing.

Cess

- It is imposed over and above the tax for a specific predetermined purpose.
- Not a permanent source of revenue, discontinued when the purpose of levying it is fulfilled. E.g. Swachh Bharat Cess

Payment of tax

- The revenue from cess is not kept under the Consolidated Fund of India.
- Not to be shared with States.
- It can be levied on both indirect and direct taxes.

Laffer Curve

- The Laffer Curve is a theory formalized by supply-side economist Arthur Laffer to show the relationship between tax rates and the amount of tax revenue collected by governments.
- The curve is used to illustrate the relationship between Government tax revenue and tax rates.

Steps Taken to Reduce Tax Avoidance in India

Double Taxation Avoidance Agreement (DTAA)

- The Tax Treaty is a bilateral economic agreement between two nations.
- **Aim:** To avoid or eliminate double taxation of the same income in two countries.

- India has DTAA with countries like Australia, Canada, Germany, Mauritius, Singapore, UAE, the UK and US.

Advanced Pricing Agreements (APA)

- It is a contract, usually for multiple years, between a taxpayer and at least one tax authority specifying the pricing method that the taxpayer will apply to its related company transactions APAs gives certainty to taxpayers, reduce disputes, and avoid tax avoidance.

General Anti Avoidance Rules (GAAR)

- GAAR usually consists of a set of broad rules which are based on general principles to check the potential avoidance of the tax in general.
- The government set up a panel under Parthasarathy Shome to review the proposals with regards to GAAR.

Base Erosion and Profit Shifting (BEPS)

- BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity.
- OECD and G20 countries along with developing countries that participated in the development of the BEPS Package are establishing a modern international tax framework under which profits are taxed where economic activity and value creation.

Prevention of Money Laundering Act,2002

- To combat money laundering in India.
- Under this, the Enforcement Directorate is empowered to conduct a Money Laundering investigation.

Vivaad Se Vishwas Scheme, 2020

- It is an amnesty scheme that offers a complete waiver on interest and penalty to the taxpayers who pay their pending taxes by March 31.

Sabka Vishwas Scheme, 2019

- Sabka Vishwas is a legacy dispute resolution scheme to free the large number of small taxpayers of their pending disputes with the tax administration.

Important Financial Institutions

Organisation for Economic Cooperation and Development (OECD)

- **Established:** 1961
- **Aim:** to stimulate economic progress and world trade.
- Most OECD members are high-income economies with a very high Human Development Index.
- **Headquarters:** Paris, France; Total Members: 36.
- India is not a member, but a key economic partner.

Enforcement Directorate (ED)

- Task of enforcing – Foreign Exchange Management Act, 1999 (FEMA) and Prevention of Money Laundering Act, 2002 (PMLA).
- It also processes cases of fugitive/ fugitives from India under Fugitive Economic Offenders Act, 2018.

Financial Intelligence Unit (FIU)

- The central national agency responsible for receiving, processing, analysing and disseminating information relating to suspect financial transactions, money laundering and related crimes.
- FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC) headed by the finance minister.
- Central Board of Indirect Taxes and Customs and Central Board of Direct Taxes (CBIC)
- Both are a part of the Department of Revenue under the Ministry of Finance created under the Central Boards of Revenue Act, 1963.

- The Central Board of Excise and Customs (CBEC) was renamed as the Central Board of Indirect Taxes and Customs (CBIC) in 2018 after the roll out of the Goods and Services Tax (GST).
- CBIC deals with the tasks of formulation of policy concerning levy and collection of Customs, Central Excise duties, Central Goods & Services Tax and Integrated GST, prevention of smuggling.
- CBDT provides inputs for policy and planning of direct taxes in India and is also responsible for the administration of direct tax laws through the Income Tax Department.

Taxation

Tax to GDP Ratio

- The size of a country's tax resources in relation to its GDP.
- **High Tax to GDP:** Financial position of the country is good. It reduces a government's dependence on borrowings. Tax buoyancy is strong.
- **Low Tax to GDP:** Constrains the government to spend and puts pressure on the government to meet its fiscal deficit targets.

Direct taxes

Dividend Distribution Tax (DDT)

- DDT is a tax levied on dividends distributed by companies out of their profits among their shareholders.
- Removed from Union Budget 2020-21.
- Instead of companies paying DDT on the dividend they give out, the dividend income will now be added to the taxable income of the recipient, and taxed at the applicable rate.

Minimum Alternate Tax (MAT)

- MAT is calculated at 18.5% on the book profit (the profit shown in the profit and loss account) or at the usual corporate rates, and whichever is higher is payable as tax.
- All companies in India, whether domestic or foreign, fall under this provision.
- MAT was later extended to cover non-corporate entities as well.

Angel Tax

- It is the income tax payable by start-ups on capital raised via the issue of shares.
- To make sure that the money coming in was genuine and to minimise fraud.

Securities Transaction Tax

- Tax levied at the time of purchase and sale of securities listed on stock exchanges.

Capital Gains Tax (CGT)

- Any profit or gain that arises from the sale of a capital asset is a Capital Gain and tax has to be paid on that, called the Capital Gains Tax. It can be short-term or long-term.
- Commodities Transaction Tax Applicable for those dealing in trading of commodities.

Tobin Tax/Robinhood Tax

- Taxing short term currency market transactions to combat market volatility.

Direct Tax Code (DTC)

- The Task Force, initially headed by former CBDT Member (Legislation) Arbind Modi and later on by Akhilesh Ranjan, was constituted in November 2017 in order to review the Income-tax Act and to draft a new Direct Tax Law.

Objective:

- Bringing more certainty to taxation of personal and corporate income and capital gains, and at bringing the gist of numerous judicial pronouncements made since 1961, when the current tax law came into force, in one place for easy reference.