Tax System

Direct Tax and Tax Slab

Taxation is the means by which a government or the taxing authority imposes or levies a tax on its citizens and business entities. From income tax to goods and services tax (GST), taxation applies to all levels.

The Central and State government plays a significant role in determining the taxes in India. To streamline the process of taxation and ensure transparency in the country, the state and central governments have undertaken various policy reforms over the last few years. One such change was the Goods and Services Tax (GST) which eased the tax regime on the sale and deliverance of goods and services in the country.

The tax structure in India can be classified into two main categories:

- Direct Tax
- Indirect Tax

Direct Tax: It is defined as the tax imposed directly on a taxpayer and is required to be paid to the government. Also, an individual cannot pass or assign another person to pay the taxes on his behalf.

Some of the direct taxes imposed on an Indian taxpayer are:

1. Income tax- it is the tax applicable on the income earned by an individual or taxpayer.
2. Corporate tax- this is the tax applicable on the profits earned by companies from their businesses.

Indirect Tax: It is defined as the tax levied not on the income, profit or revenue but the goods and services rendered by the taxpayer. Unlike direct taxes, indirect taxes can be shifted from one individual to another. Earlier, the list of indirect taxes imposed on taxpayers included service tax, sales tax, value added tax (VAT), central excise duty and customs duty.

Tax Slab

In India, we have a progressive method of taxation i.e. higher income higher the tax payable. To govern the same taxation in India is determined based on Income Tax slab which are defined by the tax department

These slab rates are different for different categories of taxpayers. Income tax has classified three categories of “individual “taxpayers such as:

- Individuals (aged less than of 60 years) including residents and non-residents
- Resident Senior citizens (60 to 80 years of age)
- Resident Super senior citizens (aged more than 80 years)

Income tax slab rate for FY 2020-21 (AY 2021-22), New Tax regime

In this new regime, taxpayers has an **OPTION** to choose either :

1. To pay income tax at lower rates as per New Tax regime on the condition that they forgo certain permissible exemptions and deductions available under income tax, Or
2. To continue to pay taxes under the existing tax rates. The assessee can avail rebates and exemptions by staying in the old regime and paying tax at the existing higher rate.

Income Tax Slab	**New Regime Income Tax Slab Rates FY 2020-21 (Applicable for All Individuals & HUF)**
Rs 0.0 – Rs 2.5 Lakhs	**NIL**
Rs 2.5 lakhs- Rs 3.00 Lakhs	5% (tax rebate u/s 87a is available)
Rs. 3.00 lakhs – Rs 5.00 Lakhs	
Rs. 5.00 lakhs- Rs 7.5 Lakhs	10%
Rs 7.5 lakhs – Rs 10.00 Lakhs	15%
Rs 10.00 lakhs – Rs. 12.50 Lakhs	20%
Rs. 12.5 lakhs- Rs. 15.00 Lakhs	25%
> Rs. 15 Lakhs	30%

- Please note that the tax rates in the New tax regime is the same for all categories of Individuals, i.e Individuals & HUF upto 60 years of age, Senior citizens above 60 years upto 80 years , and Super senior citizens above 80 years. Hence no increased basic exemption limit benefit will be available to senior and super senior citizens in the New Tax regime.
- Individuals with Net taxable income less than or equal to Rs 5 lakh will be eligible for tax rebate u/s 87A i.e tax liability will be nil of such individual in both – New and old/existing tax regimes.
- Basic exemption limit for NRIs is of Rs 2.5 Lakh irrespective of age.
- Additional Health and Education cess at the rate of 4 % will be added to the income tax liability in all cases. (increased from 3% since FY 18-19)
- Surcharge applicable as per tax rates below in all categories mentioned above:

1. 10% of Income tax if total income > Rs.50 lakh
2. 15% of Income tax if total income > Rs.1 crore
3. 25% of Income tax if total income > Rs.2 crore
4. 37% of Income tax if total income > Rs.5 crore

Income tax slab rate for Old Tax regime – FY 2020-21 (AY 2021-22)

Income Tax Slab	Individuals Below The Age Of 60 Years – Income Tax Slabs
Up to Rs 2.5 lakhs	**NIL**
Rs. 2.5 lakh -Rs. 5Lakhs	5%
Rs 5 .00 lakh – Rs 10 lakhs	20%
> Rs 10.00 lakh	30%

- Income tax exemption limit is up to Rs.2,50,000 for Individuals , HUF below 60 years aged and NRIs for FY 2018-19
- An additional 4% Health & education cess will be applicable on the tax amount calculated as above.
- Surcharge:

1. 10% of income tax, where total income exceeds Rs.50 lakh up to Rs.1 crore.
2. 15% of income tax, where the total income exceeds Rs.1 crore.

Direct Tax

A direct tax is a tax that a person or organization pays directly to the entity that imposed it. An individual taxpayer, for example, pays direct taxes to the government for various purposes, including income tax, real property tax, personal property tax, or taxes on assets.

- A direct tax is paid by an individual or organization to the entity that levied the tax.
- Direct taxes include income taxes, property taxes, and taxes on assets.

There are also indirect taxes, such as sales taxes, wherein a tax is levied on the seller but paid by the buyer.

Company Tax and Surcharge

Surcharge

A Surcharge is an additional charge or tax. A surcharge of 10% on a tax rate of 30% effectively raises the combined tax burden to 33%. In the case of individuals earning a net taxable salary of more than Rs 1 crore, a surcharge of 10% is levied on tax liability.
However, marginal relief is also provided as sometimes the increase in tax liability after factoring surcharge becomes more than the increase in income above Rs 1 crore.

Surcharge at the rate of 5% is levied on domestic corporations if net income is in the range of Rs 1 cr to Rs 10 cr. If the net income exceeds Rs 10 cr, surcharge at the rate of 10% is levied.

Surcharge at the rate of 2% is levied on foreign corporations if the net income is in the range of Rs 1 cr to Rs 10 cr. If the net income exceeds Rs 10 cr, the surcharge is increased to 5%.

Marginal relief is given to both domestic and foreign companies in case the net income exceeds Rs 1 cr and Rs 10 cr.

Cess

Cess is a tax levied for a specific purpose and ought to be used for the same only.
The process of cess levying occurs after Parliament has authorised its creation through an enabling legislation that specifies the purpose for which the funds are being raised.

- Different from the usual taxes and duties like excise and personal income tax, a **Cess** is imposed as an additional tax besides the existing tax (tax on tax) with a purpose of raising funds for a specific task.
  - For example, the Swachh Bharat cess is levied by the government for cleanliness activities that it is undertaking across India.
- The Union government is empowered to raise revenue through a gamut of levies, including taxes (both direct and indirect), surcharges, fees and cess.
- A cess, generally paid by everyday public, is added to their basic tax liability paid as part of total tax paid.
- Article 270 of the Constitution allows cess to be excluded from the purview of the divisible pool of taxes that the Union government must share with the States.

Types of Cesses

The introduction of the **The Goods and Services tax (GST)** in 2017 led to most cesses being done away with and as of August 2018, there were only seven cesses that continued to be levied.These were:

- Cess on Exports
- Cess on Crude Oil
- Health and Education Cess
- Road and Infrastructure Cess,
- Other Construction Workers Welfare Cess,
- National Calamity Contingent Duty
- Duty on Tobacco and Tobacco Products
- The **GST Compensation Cess**.
- The Finance Minister Nirmala Sitharaman introduced a new cess — a Health Cess of 5% on imported medical devices — in the Finance Bill for 2020-2021.

Total Tax

Total tax, in the context of personal income tax, is the composite total of all taxes owed by a taxpayer for the year.

Gift Tax Act

The Government introduced gift tax in April 1958 regulated by Gift Tax Act, 1958 (The GTA) with an objective to impose taxes on giving and receiving gifts under certain specific circumstances. Gifts in the form of cash, demand draft, bank cheques, or anything having value were covered.

However, the GTA was abolished in October 1998 and made all gifts tax-free. But, Gift Tax was reintroduced in a new form and included in the Income-tax provisions in 2004. It is highly important to have a basic understanding of taxation on gifts in India to avoid any ignorant /unplanned tax outflow.

Basic terms to know –

- The person who is giving a gift is called the Donor,
- The person receiving the gift is known as Donee,
- Gift is taxable in the hands of recipient.

Wealth tax

Wealth tax is imposed on the richer section of the society. The intention of doing so is to bring parity amongst the taxpayers. However, wealth tax was abolished in the budget of 2015 (effective FY 2015-16) as the cost incurred for recovering taxes was more than the benefit is derived.

Wealth tax is applicable to individuals, HUFs, and companies. The deciding factor for applicability of wealth tax is the residential status. The thumb rule is the resident Indians are subject to wealth tax on their global assets. However, NRI's fall under the ambit of wealth tax for the assets held in India.

Capital Gain Tax

Any profit or gain that arises from the sale of a 'capital asset' is a capital gain.
Land, building, house property, vehicles, patents, trademarks, leasehold rights, machinery, and jewellery are a few examples of **capital assets**. This includes having rights in or in relation to an Indian company.

This gain or profit is comes under the category 'income', and hence you will need to pay tax for that amount in the year in which the transfer of the capital asset takes place. This is called capital gains tax, which can be short-term or long-term.

Capital gains are not applicable to an inherited property as there is no sale, only a transfer of ownership. The Income Tax Act has specifically exempted assets received as gifts by way of an inheritance or will. However, if the person who inherited the asset decides to sell it, capital gains tax will be applicable.

Indirect Tax and VAT

Indirect Taxes

Indirect taxes are basically taxes that can be passed on to another entity or individual. They are usually imposed on a manufacturer or supplier who then passes on the tax to the consumer. The most common example of an indirect tax is the excise tax on cigarettes and alcohol. There are many indirect taxes applied by the government of India. Taxes are levied on manufacture, sale, import and even purchases of goods and services. These laws aren't also well-defined Acts from the government, rather orders, circulars and notifications are given out by relevant government bodies to this end. As such, it can be cumbersome trying to understand every feature of indirect taxes in India.

Different Types of Indirect Tax

There are different types of indirect tax in India. However, after the implementation of GST, all these indirect taxes were bundled into one singular tax for the citizens of India.

1. **Service tax:**
   This tax is levied by an entity in return for the service provided by them. The service tax is collected by the Government of India and deposited with them.

2. **Excise duty:**
   When any product or good is manufactured by a company in India, then the tax levied on those goods is called the Excise Duty. The manufacturing company pays the tax on the goods and in turn recover the amount from their customers.

3. **Value Added Tax:**
   Also known as VAT, this type of tax is levied on any product sold directly to customer and are movable. VAT consists of Central Sales Tax which is paid to the Government of India State Central Sales Tax which is paid to the respective State Government.

4. **Custom Duty:**
   This a tax levied on the goods imported to India. Sometimes, Custome Duty is also levied on products which are exported out of India.

5. **Stamp Duty:**
   This is a tax levied on the transfer of any immovable property in a state of India. The state government in whose state the property is located charges this type of tax. Stamp tax is also applicable on all legal documents too.

6. **Entertainment Tax:**
   This tax is charged by the state government and is applicable on any products or transactions related to entertainment. Purchasing of any video games, movie shows, sports activities, arcades, amusement parks, etc. are some of the products on which Entertainment Tax is charged.

7. **Securities Transaction Tax:**
   This tax is levied during the trading of securities through Indian Stock Exchange.

Excise Duty

Excise duty refers to the taxes levied on the manufacture of goods within the country, as opposed to custom duty that is levied on goods coming from outside the country. This means excise duty, technically, does not exist in India except on a few items such as liquor and petroleum.

Excise Duty is a form of indirect tax which is generally collected by a retailer or an intermediary from its consumers and then paid to the government. Although this duty is payable on manufacture of goods, it is usually payable when the goods are 'removed' from the place of production or from the warehouse for the purpose of sale.

There is no requirement for the actual sale of the goods for imposing the excise duty because it is imposed on the manufacture of such goods. The **Central Board of Excise and Customs (CBEC)** is responsible for collecting excise duty.

The legal framework around Excise Duty is majorly governed by the two acts-

- Central Excise Act, 1944
- Central Excise Tariff Act, 1985

Types of Excise Duty in India

Basic Excise Duty- Sometimes referred to as Central Value Added Tax (CENVAT), this type of excise duty is imposed on goods classified under the first schedule of the Central Excise Tariff Act, 1985. This duty is imposed under Section 3(1) (a) of the Central Excise Act, 1944 and levied on all excisable goods in the country except salt.

Additional Excise Duty- According to the Section 3 of the Additional Duties of Excise (Goods of Special Importance) Act, 1957, this duty is levied on goods listed in Schedule 1 of the given act. Such duty is levied on some specific goods and is charged by the central and state government as a substitute of the sales tax. The Additional Duties of Excise (Textiles and Textile Articles) Act, 1978 also provide for a similar legislation.

Special Excise Duty- This kind of duty is levied on special goods specified under the Second Schedule to the Central Excise Tariff Act, 1985.

Value-Added Tax (VAT)

- VAT is the tax which is charged on the gross margin at every stage in the sale of goods. Tax is assessed and collected at each point, starting from the manufacturer until the product reaches the retailer.
- It is a multistage tax system with provision for collection of tax paid on the purchases at every point of sale. Thus, it removes the tax-on-tax effect.
- Every state and union territory has different VAT law. Moreover, the threshold limit for exemption and the list of goods exempted also varies from state-to-state. The compliance mainly states the taxpayers reporting the sales and purchases every month along with the details of exports before the state VAT department. The information submitted is then verified by tax officials and is also subject to VAT audit once in a year.

VAT has two components, viz.

- Output VAT
- Input VAT

VAT = Output Tax – Input Tax

Output VAT: It is charged to the customer on the taxable sales made by the dealer. Here, the dealer or seller can be either the manufacturer, wholesaler, or the retailer registered under VAT. One has to register to make the sales above the prescribed limit. Once the dealer is registered, it is chargeable on all the taxable sales for a given tax period, usually every month.

Input VAT: Input VAT is the tax that is paid on the eligible purchases made by the dealer. Accordingly, when a dealer is registered under VAT, the VAT liability is to be paid in cash to the state government for a particular month. However, registered dealers can normally claim a credit for VAT charged on most business purchases.

Laffer Curve

Laffer curve was developed by the economist, Arthur Laffer. The theory analyses the relationship between tax rates and the tax revenue collected by the government. The theory relies on the argument that cutting tax rates increases the total tax revenue for a government.

Significance of Laffer Curve

1. There is an optimum tax rate, which maximises total government tax revenue. A hike in the rate beyond the optimal rate would act as a disincentive for business activities and investment activities.

2. In a case where the taxes are too high along the Laffer curve, then a cut in the tax rate will encourage economic activities and increase tax revenue. Higher tax rates decrease the incentive to invest, carry on business expansion and revenue-generating activities.

3. The underlying assumptions and the economical idea is that people will adjust their economic behaviour in the light of tax incentives given by the government.

4. The Laffer curve analyses the impact of tax rates from 0% to 100%. At a 0% tax rate, tax revenue would obviously be zero. As tax rates increase from low levels, tax revenue collected would increase.