Introduction and evolution of Indirect taxation in India

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Outline

- What is tax?
- How is tax different from fee / cess etc?
- How can tax be levied ideally?
- When, on what & on whom can tax be levied?
- What does a tax officer do?
- What are the types of taxes in India?
- What are the taxes which the States can levy under the Constitution?
- Why GST was enacted?

What is Tax

- Tax is:

 - a compulsory exaction of money

 - by public authority

 - for public purpose

 - enforceable by law

 - and not for payment of services rendered.

- This was stated by Hon’ble Supreme Court in Har Shanker Vs. Deputy Excise Commissioner defined.

Tax Vs. Fee / Cess

- A fee / cess is a consideration for services rendered. Eg: RD cess, Education cess, Market fee.
- There should be relationship between levy of fee and services rendered i.e., quid pro quo.
- A tax is levied as part of common burden and there is no quid pro quo.

• This was stated by Apex Court in Omprakash Agarwal case.

Ideal Tax - Canons of Taxation – Exceptions

- Equality – Tax levy should be equal.
  - ✓ Exception: Composition TPs.
- Certainty – Tax liabilities should be certain.
  - ✓ Exception: Retrospective legislation.
- Convenience – Taxes should be collected in a manner convenient for tax payer.
  - ✓ Exception: NIL.
- Economy – Taxes should not be expensive to collect.
  - ✓ Exception: NIL.

When, What & Whom are taxable - Components for levy of Tax

- Apex Court in Govind Saran Gangasaran case identified four components for levy of tax:

1. Taxable person
2. Taxable event
3. Taxable measure
4. Rate of tax

What does Tax Officer do – Stages in Imposition of Tax

- There are (3) stages in imposition of tax.

- Declaration of liability – in returns by TP.
- Assessment of tax for quantification of the sum liable by taxman.
- Methods of recovery if assessed tax is not paid by taxman.
- This principal is declared by Hon’ble Supreme Court in Harshad Mehta Vs. Custodian case.

Tax Types

- Direct taxes

 - Levied on incomes i.e., profits.

 - Cannot be passed on to others.

 - eg: Income tax, Corporate tax.

- Indirect taxes

 - Levied on consideration.

 - Collected from the ultimate consumers.

 - eg: VAT, GST.

States’ Power to Tax under Constitution

- Article 246 A & List 3 of 7th Schedule after 101 Amendment.
- Empowers Parliament or State Legislature to levy tax on goods & services (GST).
- Liquor for human consumption & Petrol are excluded from GST.
- Article 246 empowers State to levy tax on sale of Liquor & Petrol under VAT.
- Article 246 also empowers Centre to levy tax on inter-state sales of Liquor & Petrol.

Why was GST Enacted – Evolution of Indirect Taxes

- Indirect taxes are mainly levied on:

 - Manufacture of goods as Excise duty.

 - Import of goods as Customs duty.

 - Supply of services as Service tax.

 - Sale of goods as Sales tax.

- The first three are levied by Centre.
- Last one is levied by the States.

Taxes levied by States earlier to GST

- VAT – on sale **of goods.**
- Entertainment Tax – on Cinemas & Cable operators' **services**.
- Entry Tax – on Entry of **goods** & motor vehicles.
- Luxury Tax – on luxury **services** provided in hotels & hospitals.
- HRBT – on betting amount in horse race club.
- CST – on sale of **goods**, levied by centre but collected and appropriated by state.
- Rural Development Cess – cess on **goods**, i.e., paddy component on FCI levy rice.
- Profession Tax – on professions, employees & callings.

Indirect Taxes levied by the Centre prior to GST

- Central Excise – on manufacture of goods.
- Service Tax – on supply of services.
- CST - on sale of **goods**, levied by centre but collected and appropriated by state.

Landmarks in History of Indirect Taxation in the States

- Sales Tax & Entertainment Tax of Madras State, 1939.
- Hyderabad General Sales Tax,1950.
- A.P. General Sales Tax, 1957.
- Originally tax on sales of goods under Sales Tax.
- Extended to deemed sales, i.e., works contract, lease rentals, hotels by 46th amendment in Constitution,1982.
- Charging Section introduced in 1995.

Continued..

- Originally tax on all goods including live stock.
- Later exemption list included for perishables.
- Tax leviable either at the first point or at the last point.
- Originally multiple rates of tax, in 1997 tax rates rationalised to 3 rates, i.e., 1%, 4% & 12%.
- VAT introduced provisionally for some commodities, 1997.
- VAT introduced on all commodities, 2005.

Evolution of indirect taxes

- All the indirect taxes were levied on ad valorem basis.

- Sales tax was levied on total sale price at every stage.

- Excise duty was levied on total price at manufacture level.

- This created a cascading effect of tax.

Cascading Effect of Tax

Inputs

- Cost : Rs.10,000/-
- Tax @10% : Rs. 1,000/-
- Total : Rs.11,000/-

Output

- Cost of input : Rs.11,000/-
- Add: GP 10% : Rs. 1,100/
- Sale value of goods: Rs.12,100/-

Tax payable

- @10% on total price: Rs. 1,210/-
- Total sale price : Rs.13,310/-

Continued..

- Tax paid on raw material became part of value.

- Therefore, tax was paid on the tax component also.

- This is cascading i.e., tax on tax, so Indian goods became costly.


CASCADE

Contd...

- All indirect taxes shifted from ‘ad valorem’ to ‘value added tax’ system from 2005 onwards.
- In this system tax paid at the earlier stage is given back as credit to purchaser.
- This credit is called as input tax credit or ITC.
- ITC is deducted from the tax payable at subsequent stage.
- Thus there is no tax on tax.

How Input Tax Credit Works

⑩Tax paid on purchases

⑩Rs.8,000/- (paid by the seller to Govt.)

⑩Tax payable on sales

⑩ Rs.10,000/-

⑩Tax payable to Government by last seller

⑩Rs.10,000 – Rs.8,000 = Rs.2,000/-

Effect of VAT

- Value of goods & Tax accounted separately.
- Therefore, no GP on tax and no tax on tax.

Inputs

- Cost :Rs.10,000/-
- Tax @10% :Rs. 1,000/- (ITC)
- Total : Rs.11,000/-

Output

- Cost of input : Rs.10,000/-
- Add: GP 10% :Rs. 1,000/
- Sale value of goods :Rs.11,000/-

Tax payable

- @10% on total price : Rs. 1,100/-
- Less ITC :Rs. 1,000/-
- Tax paid to Govt. :Rs. 100/-
- Total sale price :Rs.12,100/-

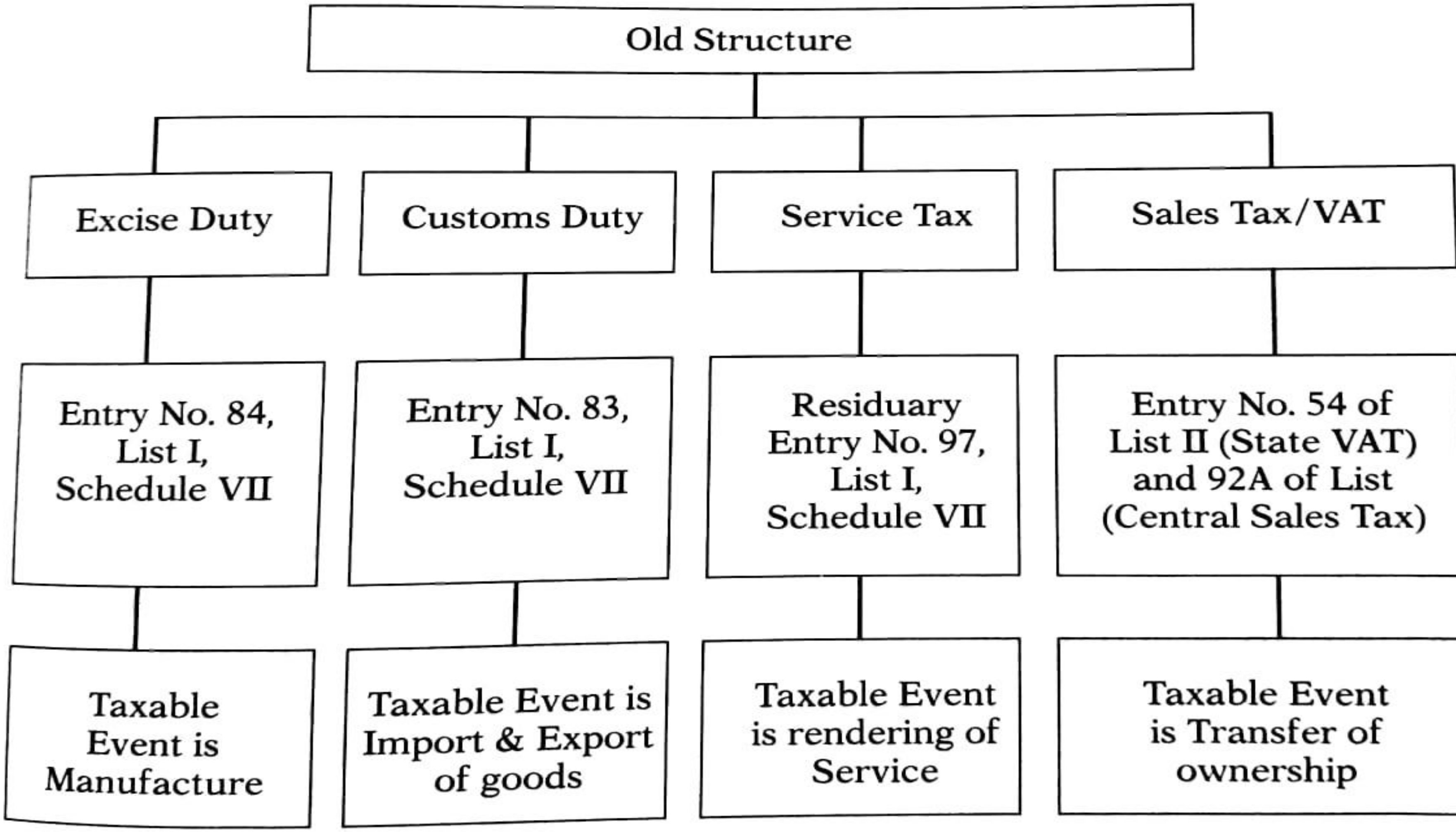
Deficiencies of VAT System

- Input Tax Credit is given only on within State purchases.
- Central Excise Duty component was taxed in VAT.
- CST paid on inter-state purchases not creditable.
- Tax paid on services not creditable in VAT.
- Tax on inter-state sales not given to State of consumption but given to State of Origin.
- Thus, tax on tax continued.
- GST introduced to overcome all the above.

Effect of GST

- Single integrated tax system in form of ‘Goods and Services Tax’ introduced.
- Tax on Goods & Services purchased anywhere in the Country is ITC.
- Tax on inter-state transaction accrue to the consuming States.
- Single return in place of multiple returns.

Pre-GST Multiple Tax Structure



Taxes subsumed by GST

Central Indirect Taxes	*State Indirect Taxes*
Central Excise duty under Central Excise Act, 1944	State Value Added Tax/Sales Tax
Additional Excise duty	Entertainment tax (other than tax levied by local bodies)
Excise duty levied under Medicinal and Toilet Preparations (Excise Duty) Act, 1955	Central Sales Tax (levied by Centre and collected by State)
Service Tax under Finance Act, 1994	Octroi duty
CVD (Additional Customs Duty)	Entry Tax
Special Additional Duty of Customs	Purchase tax
Central Surcharge	Luxury Tax
Central Cesses	Lottery tax
	Betting and Gambling tax
	State Surcharges
	State Cesses

New Structure

- SGST – State GST.
- CGST – Central GST.
- IGST – Integrated GST.

Summary

- Meaning of tax.
- Tax Vs. fee / cess etc.
- Essential components for levy of tax.
- Cannons of taxation.
- Tax types.
- States' power to tax under constitution.
- Evolution of indirect tax system culminating in GST.

Quick Evaluation

1. Tax is voluntary payment for services rendered by the Govt. (True / False).
2. Taxable Measure can be value or quantity or quality (True / False).
3. “Quid pro quo” is seen in (Tax/Cess).
4. Which of the canons of taxation do not have an exception. (Equality, Certainty, Convenience, Economy).
5. Taxman does not do one of the following. (Declaration of liability, Assessment of tax, Collection of Tax).

Quick Evaluation

6. Goods & Services Tax is levied on (Income/ Expenditure /Consideration received from supplies).
7. Ad valorem tax is levied on (Total value/Value addition).
8. In GST, tax is levied at every stage in the chain of value addition, therefore there is a cascading effect of tax (True/False).
9. A businessman paid tax on his purchases and then used this tax as ITC. Did the tax paid on purchases come to Govt. Treasury. (Yes/No).
10. GST is not levied on Liquor & Petrol (True/False).

THANK YOU