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## ***DIRECT TAX AT A GLANCE***

### **THIS CHAPTER INCLUDES**

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|-----------------------------|---|
| 1. An Introduction          | 4. Direct vs. Indirect Tax                |
| 2. Characteristics of Taxes | 5. Background of Taxation System of India |
| 3. Objectives of Taxation   | 6. Tax Structure & Administration         |

### **CHAPTER AT A GLANCE**

#### **Meaning of Tax**

A tax is a financial charge or other levy imposed upon a taxpayer (an individual or legal entity), collected by a state or the functional equivalent of the same, such that failure to pay, or evasion of or resistance to collection of tax, is punishable by law.

#### **Rationale to levy Tax**

- Expenditures on war,
- The enforcement of law and public order,
- Protection of property,
- Economic infrastructure (such as roads, legal tender, enforcement of contracts, etc.),
- Public works,
- Social Engineering,
- The operation of Government itself

#### **Characteristics of Taxes**

- Tax is Compulsory and not voluntary
- Tax is Contribution
- Tax is for Public benefit

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| <ul style="list-style-type: none"> <li>• Tax is paid out of Income of the tax payer</li> <li>• Government has the power to levy Tax</li> <li>• Tax is not the cost of the benefit</li> <li>• Tax is for the economic growth and public welfare</li> </ul>  |  |
| <b>Objectives of Taxation</b>  |  |
| <ul style="list-style-type: none"> <li>• Source of Revenue to Government</li> <li>• Redistribution of Income and Wealth</li> <li>• Social welfare</li> <li>• Safety of society from bad and injurious customs</li> <li>• Economic Significance of Taxes</li> <li>• Economic growth</li> <li>• Enforcing government Policy</li> <li>• Economic Stability</li> </ul> |  |
| <p><b>Direct Taxes:</b> Taxes which are directly levied on Income of the person and its burden cannot be shifted. For example - Income Tax.</p> <p><b>Indirect Taxes:</b> Indirect taxes are imposed on price of goods or services. Person paying the indirect tax can shift the incidence to another person. For example - GST or Customs duty.</p>               |  |
| <b>Tax Structure</b>   |  |
| <b>Central Government</b>  | <ul style="list-style-type: none"> <li>• Customs including export duties</li> <li>• Excise on Tobacco and other goods manufactured in India except alcoholic liquors for human consumption, opium, narcotic drugs</li> <li>• Corporation Tax</li> <li>• Taxes on inter-state trade of goods other than newspapers</li> <li>• Taxes on inter-state consignment of goods</li> <li>• Any other matter not included in List II or III</li> </ul> |

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| <b>State Government</b> | <ul style="list-style-type: none"> <li>• Taxes on agricultural income</li> <li>• Excise duty on alcoholic liquors, opium and narcotics</li> <li>• Octroi or entry Tax</li> <li>• Tax on intra state trade of goods other than newspapers</li> <li>• Tax on advertisements other than that in newspapers</li> <li>• Tax on goods and passengers carried by road or inland waterways</li> <li>• Tax on professionals, trades, callings and employment</li> </ul> |
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**TOPIC NOT YET ASKED BUT EQUALLY IMPORTANT FOR EXAMINATION**

## **DISTINGUISH BETWEEN**

**Q. 1.** Distinguish between Direct tax and Indirect Tax.

**Answer:**

### **Differences between Direct Tax and Indirect Tax**

| <b>Point of Difference</b>    | <b>Direct Tax</b>  | <b>Indirect Tax</b>   |
|-------------------------------|--|---|
| <b>Meaning</b>                | Direct tax is a tax wherein the levy of tax is made on a person and the responsibility of paying such tax is fixed on that person. | In this the levy of tax is made on one person and the responsibility of paying the tax to the Government is fixed on some other person. |
| <b>Levy</b>                   | Direct tax is levied on person.  | Indirect tax is levied on goods and services.   |
| <b>Transfer of Tax Burden</b> | The burden of direct tax cannot be transferred to other person   | The burden of indirect tax can be transferred to the end users.   |

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| <b>Effect</b>  | The purpose of direct tax is to redistribute the wealth of a nation | Indirect tax increases the price of goods or services. |
| <b>Example</b> | Income Tax.   | Goods and Services Tax.                                |
| <b>Penalty</b> | It is levied on the Assessee.                                       | It is levied on supplier of Goods & Services.          |

## DESCRIPTIVE QUESTIONS

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**Q. 1.** What is the rationale to levy tax?

**Answer:**

**Rationale to levy Tax:** The taxes collected have been used by the government to carry out many functions. Some of these include:

- Expenditures on war,
- The enforcement of law and public order,
- Protection of property,
- Economic infrastructure (such as roads, legal tender, enforcement of contracts, etc.),
- Public works,
- Social Engineering,
- The operation of Government itself, and
- To fund welfare and public services such as education systems, health care systems, pensions for the elderly, unemployment benefits, and public transportation, energy, water and waste management systems, common public utilities, etc.

**Q. 2.** Discuss the characteristics of good tax system.

**Answer:**

### **Characteristics of Good Tax System**

1. **Tax is Compulsory and not voluntary** – A tax is imposed by law. So tax is compulsory payment to the Governments from its citizens. Tax is duty of every citizen to bear his share for supporting the government. The tax is compulsory payment, refusal or objection for paying tax due leads to punishment or is an offence of the Court of law.

2. **Tax is Contribution** – Contribution means in order to help or provide something. Tax is contribution from members of community to the Government. A tax is the duty of every citizen to bear their due share for support to government to help it to face its expenditures. Some wants are common to everybody in the society like defence and security, so these wants cannot be satisfied by individuals. These social wants are satisfied by Governments, hence it is the duty of the people to support government for these social wants.
3. **Tax is for Public benefit** – Tax is levied for the common welfare of society without regard to benefit to any special individual. Government proceeds are spent to extend common benefits to all the people.
4. **Tax is paid out of Income of the tax payer** – Income means money received, especially on regular basis, for work or through investment. Tax is paid out of income as long as the income becomes realized, here the tax is imposed. Income owner has profit from any business, so he should pay his share to support the Government.
5. **Government has the power to levy Tax** – Governments are practicing sovereign authority upon the citizens through levying of taxes. Only government can collect tax from the people.
6. **Tax is not the cost of the benefit** – Tax is not the cost of benefit conferred by the government on the public. Benefit and taxpayer are independent of each other, and payment of taxation is of course designed for conferring of benefits on general public.
7. **Tax is for the economic growth and public welfare** – Major objective of the government is to maximize economic growth and social welfare. Developmental activities of the nations generally involve two operations, the raising of revenue and the spending of revenue, so the government spends taxes for economic benefit, for entire community and for aggregate welfare of the society.

**Q. 3.** Discuss the objectives of taxation.

**Answer:**

**Objective of Taxation**

1. **Source of Revenue to Government:** Taxes are imposed so as to produce the necessary amount of revenue to meet the requirement of

the government, as the public expenditure is increasing in scope and size day by day. Therefore, the main objective of taxes is to raise revenue to meet the government expenditures adequately.

2. **Redistribution of Income and Wealth:** Income differs from one person to another in the society. Inequity in income leads to many evils, and the government aims to reduce inequalities between members of the society, to secure social justice. Tax is a means of ensuring the redistribution of income and wealth in order to reduce poverty and promote social welfare.
3. **Social welfare:** Social welfare is the basic need of the society in the modern age. The government functions have become very important to the society, because the society needs saving, protection, education, health, and so on. All these functions are necessary to make social welfare, so the government receives revenue from tax, and expends it for those functions.
4. **Safety of society from bad and injurious customs:** Fighting the bad customs in the society is the primary task of the government, so tax is a tool for fighting some of those customs. From this angle tax imposition of very high percentage on the goods like tobacco and alcohol is an effort to reduce these habits.
5. **Economic Significance of Taxes:** Taxes are used from economic point of view, so taxation helps to encourage some economic activities, and as a tool to solve some economics problems. Tax is also a means for directing of scarce economic activities.
6. **Economic Growth:** Economic development is the main objective in all the countries of the world. Economic development depends on mobilization of resources and efficient use of such resources between different sectors of the economy activities. Tax policy must be designed so as to mobilize the internal resources and use these resources in productive manner.
7. **Enforcing Government Policy:** Government policy can easily be enforced by adoption of suitable tax policy. The Government can encourage investment, saving, consumption, export, protection of home industry, employment, production, protection of society from harmful customs, and economic stability through suitable tax policy.

8. **Economic Stability:** Maintaining economic stability is one of the tax objectives. Economic stability is a very important factor for the sustained economic growth. Government can effectively use taxes in the case of inflation and depression. These may be increased in inflationary situations. Increase in the rates of existing taxes and the imposition of new taxes would check consumption, decrease the level of effective demand and therefore help in bringing up stability in prices.

**Q. 4.** Discuss some merits of direct taxes and indirect taxes.

**Answer:**

**Merits of Direct Tax**

1. **Equity:** Direct taxes have equity of sacrifice, depend upon the volume of income. They are based on the progressive principle, so rates of tax increase as the level of income of a person rises.
2. **Elasticity and productivity:** Direct taxes have elasticity because when the government faces some emergency, like earthquake, floods and famine, the government can collect money for facing those problems through the mode of Direct tax.
3. **Certainty:** Direct tax has certainty on both sides 'tax-payer' and 'government'. The tax-payers are aware of the quantity of tax. They have to pay and rate, time of payment, manner of payment, and punishment from the side of government is also certain about the total amount they are getting.
4. **Reduce inequality:** Direct taxes follow progressive principles so it is taxing the rich people with higher level of taxation and the poor people with a lower level of taxation.
5. **Good instrument in the case of inflation:** Tax policy as fiscal instrument plays important role in the case of inflation, so government can absorb the excess money by raising in the rate of existing taxes or imposition of new taxes.
6. **Simplicity:** The rules, procedures, regulations of income tax are very clear and simple.

**Merits of Indirect Taxes**

1. **High revenue production:** Nature of indirect taxes is imposition on the commodities and services. Here indirect taxes cover a large number of essential goods and luxurious goods which are consumed by the mass both rich and poor people, these help in collecting large revenue.
2. **No evasion:** Nature of indirect tax is that, it is included in the price of commodity, so tax evasion or tax avoidance is difficult.
3. **Convenient:** Indirect taxes are small amount and indirect taxes are hidden in the price of goods and services, hence the burden of these taxes is not felt very much by the tax-payers, and not lump sum like direct taxes.
4. **Economy:** Indirect taxes are economical in collection and the administrative costs of collection are very low. Also the procedure of collection of these taxes is very simple.
5. **Wide coverage:** Indirect taxes cover almost all commodities like essential commodities, luxuries, and harmful ones.
6. **Elasticity:** Since a large number of commodities and services are covered by indirect taxation there is great scope for modifying of taxes, goods and tax rate, much depends on nature of goods and on their demands.