

CHAPTER 6

DIRECT AND INDIRECT TAXES

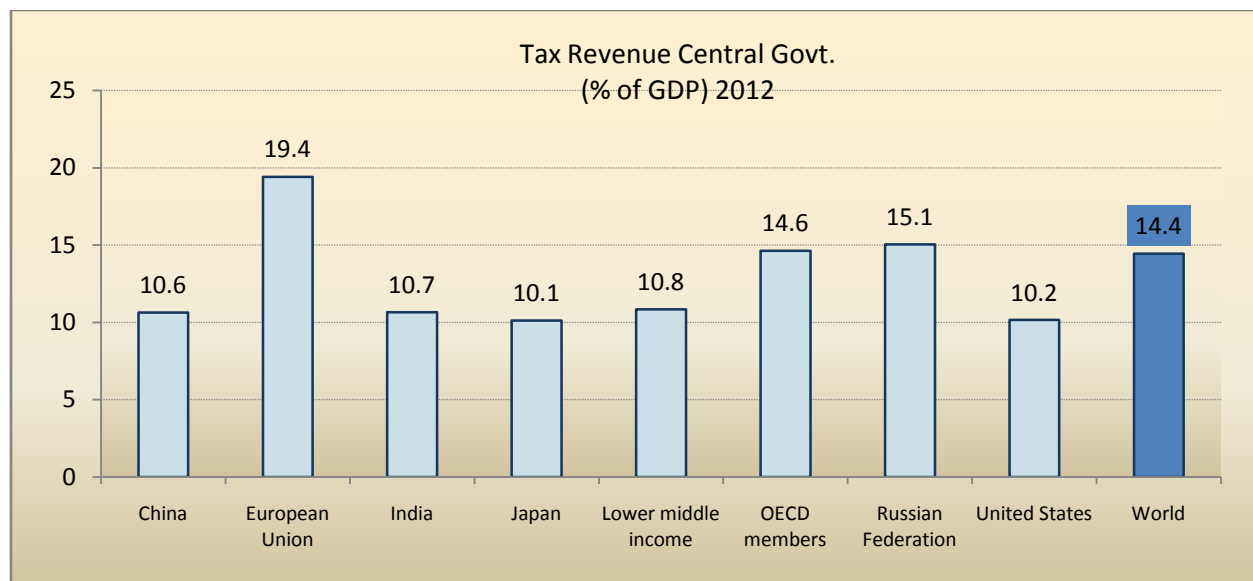
6.1 Changing Scenario & Tax Reforms: Tax systems the world over have undergone significant changes during the last twenty years as many countries across the ideological spectrum and with varying levels of development have undertaken reforms. The wave of tax reforms that began in the mid-1980s and accelerated in the 1990s, was motivated by a number of factors. In many developing countries, pressing fiscal imbalance was the driving force. Tax policy was employed as a principal instrument to correct severe budgetary pressures. In others, the transition from a planned economy to a market economy necessitated wide ranging tax reforms. Besides efficiency considerations, these tax reforms had to address the issues of replacing public enterprise profits with taxes as a principal source of revenue and of aligning tax policy to change in the development strategy. Another motivation was the internationalization of economic activities arising from increasing globalization. On the one hand, globalization entailed significant reduction in tariffs, and replacements had to be found for this important and relatively easily administered revenue source. On the other, globalization emphasized the need to minimize both efficiency and compliance costs of the tax system. The supply-side tax reforms of the Thatcher– Reagan era also had their impact on the tax reforms in developing countries.

6.2 Unlike most developing countries, which were guided in their tax reforms by multilateral agencies such as the International Monetary Fund, Indian tax reforms have largely borne a domestic brand. Thus, even when the government sought assistance from multilateral financial institutions, the recommendations of these institutions did not directly translate into an agenda for tax reform. Despite this, the tax system reforms were broadly in conformity with international trends and advice proffered by expert groups and was in tune with international best practices. Inevitably tax policy in the country has responded to changing development strategy over the years and to the changing global scenario. Some of the changes during past few years include reduction in excise duties in post global financial & economic crisis, alignment of custom tariffs to the levels prevailing in ASEAN countries, introduction of Service tax in 1994-95 besides introduction of the Constitution(115th Amendment) Bill in the Lok Sabha in March 2011 to operationalize 'Goods & Services Tax'(GST).

6.3 In India, the authority to levy taxes is divided between the Union government and the State Governments under the relevant Acts. The Union Government levies direct taxes such as personal income tax and corporate tax, and indirect taxes like custom duties, excise duties and central sales tax. The States are empowered to levy State sales tax and other local taxes like entry tax, octroi, etc.

6.4 Tax GDP Ratio- Worldwide: India is believed to have lower tax GDP ratio. As per World Bank Database (Taxes collected by Central Government) the 10.7 % ratio in case of India , during 2012, is less than the world average of 14.4 % and much lower than 19.4 % ratio in case of European Union , which has traditionally higher levels of Tax GDP Ratio. Neighboring economies like Bangladesh & Pakistan also have ratio at

around 10%. Some argue that higher tax GDP ratio translates into better infrastructure etc by taxing the rich through direct taxes but in the globalised world, things have become increasingly complex as lower taxes might attract more business.



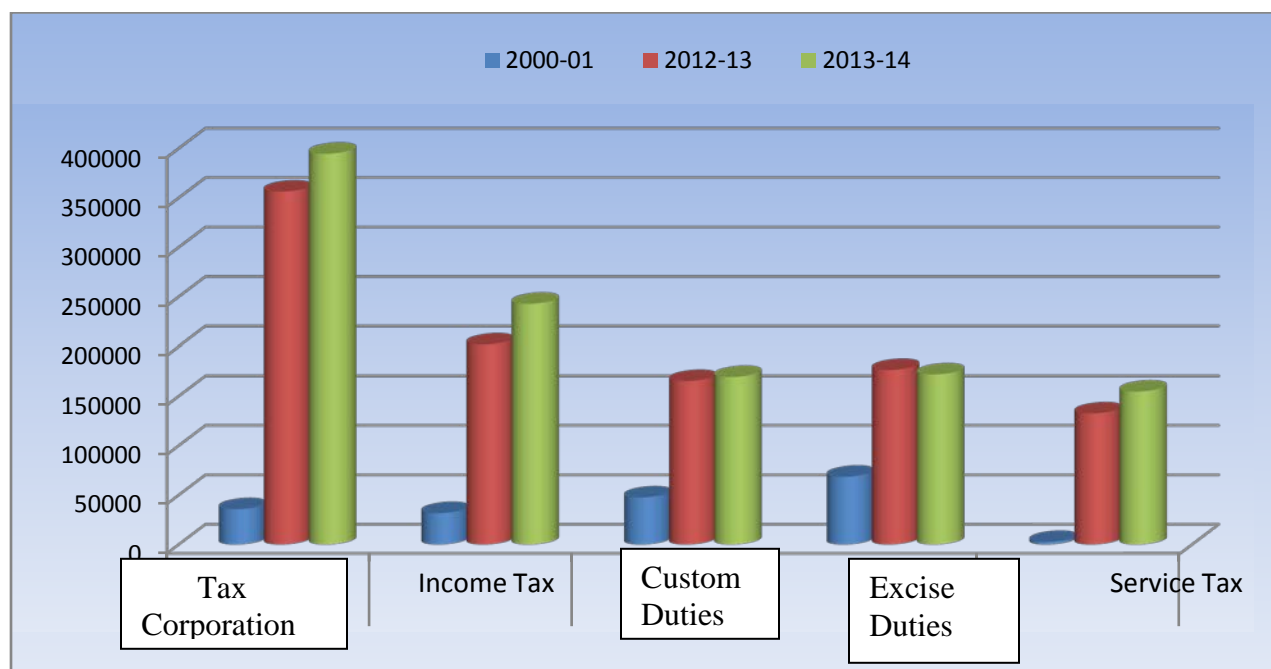
6.5 Overall tax ratio (including State taxes, social security contributions etc) is also widely used by many, including OECD countries. As per the data compiled by them, the average tax to GDP ratio in OECD countries was 34.6 per cent in 2012 compared with 34.1 per cent in 2011 and 33.8 per cent in 2010. In US (24%) & Japan (28%) on the other hand, continue to have the ratio below 30 % .The Recent recovery of OECD countries is still below the most recent peak year of 2007 when tax revenues to GDP ratios averaged 35.0 per cent. In India too, even though the tax GDP ratio increased marginally during 2008-09 and 2009-10 , the annual growth rate (about 2-3 %) was far below the period immediately preceding and succeeding these years when the growth was more than a quarter (i.e. above 25%). As per Indian Public Finance Statistics 2012-13, Ministry of Finance, including States share also, India's tax – GDP ratio was expected to be around 17.2% reaching to about the same level as before financial crisis in 2008.

6.6 As one moves up the income ladder , the ratio is expected to climb because it is non subsistence income that are taxed . But much wealthier countries in the region like Malaysia & Thailand also do not have significantly higher tax GDP ratio (Central Govt taxes : 2013) with the values at 16.1&16.5 % respectively , even though their higher per capita income puts them in an advantageous position to bear higher tax burden. Even China, which has about three times per capita income compared to India, has tax GDP ratio at levels identical to that of India. Hence the level of taxation in case of India seems in consonance with the prevalence elsewhere in Asia. However, introduction of comprehensive goods & services tax (GST) and plugging the tax evasion might increase the revenues further.

Revenue Realization Through Taxes- India :

6.7 As per the provisional results, during 2013-14, total revenue realized through direct & indirect taxes was Rs 1134829 Crore , an increase of 9.8% over the previous year which was an increase of about 16% in the year 2012-13. While revenue realization through direct taxes (Rs 638591 Crore) increased by 14.3 % over the previous year , the collections through indirect taxes (Rs474482 Crore) saw an increase of only 4.6 %, less than previous year. In direct taxes category, revenue from corporation tax increased by about 10.8% compared to previous year whereas that from income tax increased by 20.4%. Among components of indirect taxes, collections from custom duties , central excise and service tax saw an increase of 12.3, 15.2 & 13.6 % respectively. Revenue from petroleum accounted for more than half of the total revenue collections from excise. Following graph shows a comparative picture of the collections from direct & indirect taxes over a decade.

Revenue Realization from taxes (Rs Crores)



6.8 Composition of Tax collections : Due to different rates of growth in different components, the composition of revenue from tax collection has undergone significant change over the last decade.

6.9 Indirect Taxes : During 2001-02 , excise duties with a share of about 39 % constituted the major portion of total tax collection (including both direct & indirect taxes). Their share in 2013-14, has however more than halved to about 15.16 % and was larger only to collections from service tax (14%), which started with negligible (2%) share in 2001-02. Reduction in excise duties was a key component of the fiscal stimulus

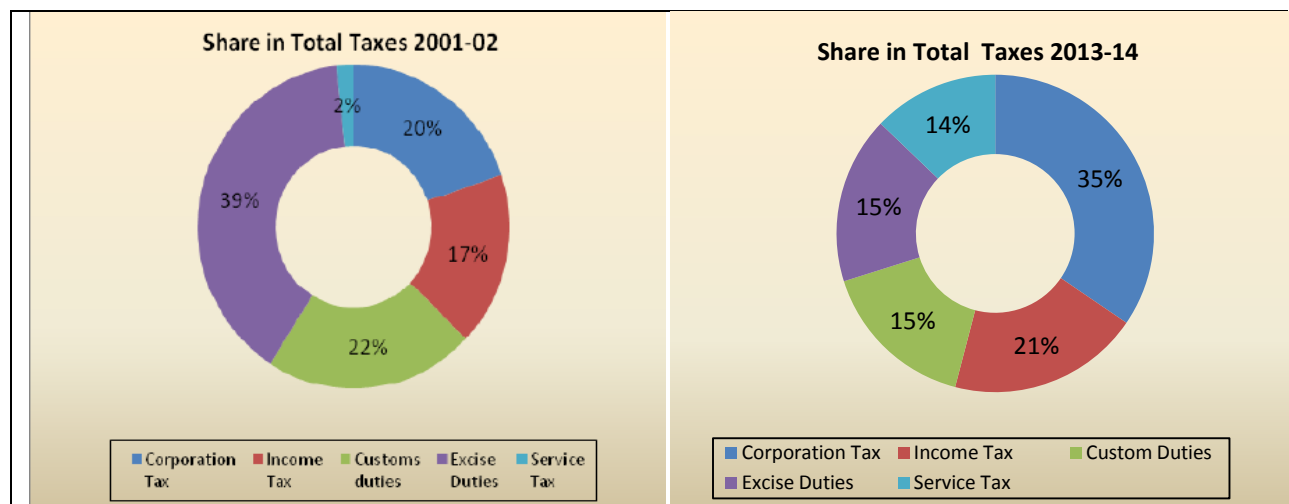
package announced in the wake of the global financial and economic crisis and its impact on the economy.

6.10 Other component which has seen a decline during the period is customs duties (22 % to 16 %). As part of the announced long-term commitment to align custom tariffs to those prevailing in Association of South East Asian Nations (ASEAN) countries, peak rates of customs have been progressively reduced since the beginning of the reform process in 1991 to about 10 per cent in the Budget for 2007- 08.

6.11 Consequently, the overall share of indirect taxes has reduced to about 46% as compared to 63 % in 2001-02. The decrease in share of indirect taxes is despite sharp increase in service tax collections. The introduction of service tax in 1994-95 ushered in a major structural change in indirect taxes in the form of a wider tax base and facilitated the process of rationalization of excise duties resulting in lower tax burden on productive sectors. Over the years, there has been an increase in the number of services and the rate of service tax leviable. Recent budgets have continued with service tax rate of about 12.5 per cent.

6.12 **Direct Taxes** : Significant increase in corporation tax from Rs 36609 crores in 2001-02 to Rs 394677 (about ten times) in 2013-14 has led the increase in share of direct taxes and has made corporation tax as the most significant source of revenue with about 35 % share in total revenue collections in 2013-14. As a proportion of gross tax revenue, direct taxes have been accounting for over a half of the total since 2007-08.

Changes In Composition Of Overall Tax Over A Decade



6.13 Double digit annual growth in total tax collections has been seen since 2002-03 except for 2008-09 & 2009-10 when it was merely 1.7 & 3.3 % respectively. During the period of muted growth, indirect taxes saw a decline (3.4 & 8.9 % respectively) in annual growth whereas moderate growth was seen in case of revenue from corporation tax, largely on the account of slowdown due to global financial crisis. In fact, collection from income tax also declined (-0.3%) during 2008-09. Corporation tax registered lowest growth rate (8.2%) , falling below 2 digits since 2002-03.

6.14 **Sources of Statistics related to Taxes:** The Budget documents of Centre and State Governments provide details of taxes, both direct and indirect taxes. The **Department of Revenue, Ministry of Finance** is responsible for all matters relating to the administration of Central taxes, The **Central Board of Direct Taxes (CBDT)** administers the direct taxes through its subordinate organization namely Income Tax Department while the **Central Board of Excise and Customs (CBEC)** is responsible for the administration of indirect taxes through Departments of Customs and Central Excise.

6.15 The **Research and Statistics Wing of the Directorate of Income Tax (RSP&PR)** of the CBDT is engaged in the collection and compilation of direct tax statistics from 300 field units located throughout the country. The data flow from the field offices of the Commissioners and Chief Commissioners of income tax to the Directorate of Income Tax (RSP&PR), where they are consolidated at the all- India level. The Directorate prepares different statistical statements and reports of different periodicities (monthly, quarterly and annual) based on the information received from the field offices.

6.16 Indirect taxes include taxes from Customs Duty, Central Excise Duty, Service Tax, Sales Tax, Value Added Tax (VAT), and Securities Transaction Tax (STT). The data pertaining to Central excise and customs are collected under Central Excise and Custom Law and Rules framed there under. The data flow from the range office (lowest formation of Central excise) to Commissionerate office through divisional offices and finally, to the **Directorate of Statistics and Intelligence**, which in turn submit the Reports to CBEC.

References:

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- World Bank Database-World Development Indicators & Global Development Finance.