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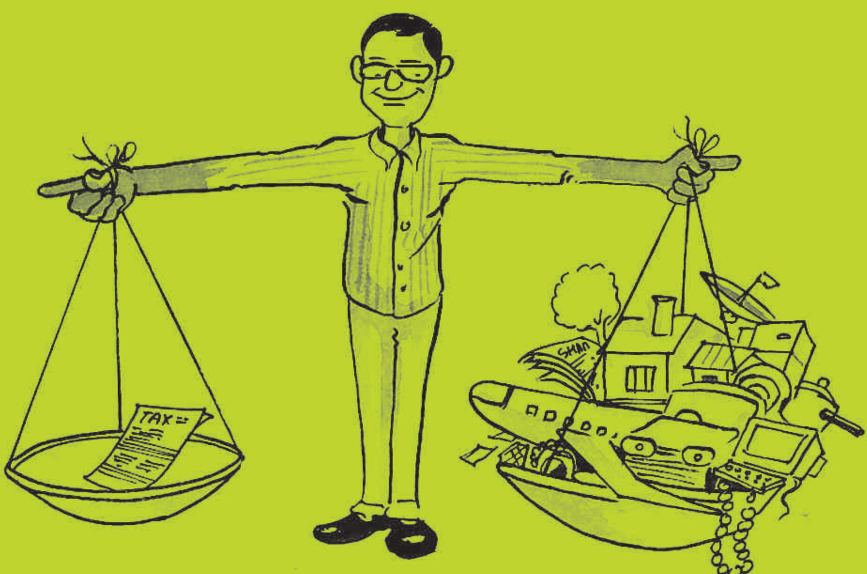
# A Primer on Taxes



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**Authors:** Debdulal Thakur*, Sankhanath Bandyopadhyay
**Edited by:** Vijay Thappa, Pooja Parvati, Subrat Das
**Editorial Inputs:** Matti Kohonen (Tax Justice Network), Oliver Pearce (Christian Aid - UK)
**Illustration:** Snehal Sharma and Vikram Nayak
**Design:** Mayank Bhatnagar (DESIGM)
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* Debdulal Thakur works with National Institute of Public Finance and Policy (NIPFP); views expressed by him in this publication are personal.

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**Centre for Budget and Governance Accountability**
A-11, Second Floor, Niti Bagh, Khel Gaon Marg
New Delhi - 110049, India
Phone: +91-11-41741285/86/87
Email: info@cbgaindia.org
Web: www.cbgaindia.org

# A PRIMER ON TAXES

2011

Centre for Budget and Governance Accountability
A-11, Second Floor, Niti Bagh, Khel Gaon Marg
New Delhi - 110049, India
Phone: +91-11-4174 1285/86/87
Email:info@cbgaindia.org

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# Section 1: What is Tax?

Taxes refer to the money collected by the government through payments as imposed by law. Through the march of history, reasons for collection of taxes have ranged from expenditure on war, maintenance of law and order, protection of property, providing economic infrastructure, carrying out public works and for running the government itself. Governments of welfare States today use taxes to fund public welfare like education, health and related social sector services besides offering public utilities. A high level of taxation is essential in a welfare State to fulfil its ever-growing social obligations. Apart from meeting social expenditures, taxation has another important objective of reducing the inequalities of income and wealth.

The system of taxation dates back to olden times, finding mention in chronicles about ancient Egypt and Persia and being recorded in the Bible and other scriptures. Before the concept of currency was introduced, when barter trade was prevalent, taxes used to be collected in the form of agricultural produce and livestock besides gold, silver and copper coins. In India, there are references to it in the treatises “Manu Smriti” and “Arthashastra” besides the *jizya* (poll tax formerly paid by minority religious groups) imposed by Islamic rulers as far back as the 11th century AD. The system was abolished by Mughal emperor Akbar and re-imposed by his great grandson Aurangzeb. During British colonial rule, the system underwent a sea-change, culminating in the arbitrary Salt Tax, which served as a turning point in the India’s freedom movement.

Since Independence, the system of taxation has evolved. It earlier lacked transparency, but today people have Permanent Account Number (PAN) cards to keep track of taxes paid by individuals, the corporate sector and other entities. There is another school of thought which argues that the tax systems in independent States simply “copied the colonial tax code” with some minor changes. Also, the signing of double-tax treaties was made after the colonial era ended, creating an unequal international tax system, regulating international tax payments.

Though the nature of taxes and their collection varies across countries, there are predominantly two types – direct tax and indirect tax –concepts which will be discussed in subsequent sections of this primer.[1]

1 According to the IMF classification in the 'government finance manual', which is a reference point for classifying internationally comparable public finances, the classification is as follows:
1. Taxes on income profit, and capital gains
2. Taxes on payroll and workforce
3. Taxes on property
4. Taxes on goods and services
5. Taxes on international trade and transactions
6. Other taxes

# Section 2: Significance of Taxation in the Indian Context

The British left India a few ‘Public Sector’ enterprises like the Railways, Posts & Telegraph and Port Trust, to name a few. Immediately after Independence, the sector was saddled with the responsibility of charting the path of economic development. As a result, fiscal measures were the only instrument for the economic development of India.

The role assigned to the public sector and the objectives of the fiscal policy[2] in India were based on:

1. The encouraging experience of western countries regarding the use of fiscal policy as an instrument for achieving economic and social objectives.
2. The economic and political requirements that prevailed in the country at the time of Independence.

The role of fiscal policy as an instrument for efficient allocation of resources, economic growth and economic equality came to be recognised after World War II. Developed economies had used fiscal policy most effectively to achieve equitable distribution of income and wealth, economic stability and allocative efficiency.[3]

The post-war economic performance of most western countries in respect to employment, production and growth has been vastly superior to that of pre-war years.[4] It is argued that this was mainly since, “governments have increasingly accepted responsibility for the promotion and maintenance of high employment and steady growth”.[5] Further, it was observed that where fiscal policy has been used consistently, it made a major contribution to the achievement and maintenance of high employment. The encouraging experience of developed economies has significant influences upon the usage of fiscal policy to foster economic growth of less developed economies.

[2] ‘Fiscal policy’ encompasses the taxation and expenditure policy of a government.
[3] ‘Allocative efficiency’ refers to efficient allocation in various sectors to minimise the cost of producing goods and services.
[4] ‘Fiscal Policy for a Balanced Economy: Experience, Problems & Prospects’, OECD, December 1968, p.23
[5] ibid.p-97

In this context, the increasing role assigned to the public sector and fiscal policy in promoting economic growth and social justice in India was considered inevitable due to the abysmal (just after Independence) socio-economic conditions prevailing in the country. The following are some key features prevailing in the Indian economy at the time of Independence:

- Low levels of per capita income, low levels of savings and investment, inadequate infrastructure and social and economic overheads.
- Lack of institutional finance and investment prospects.
- Rampant poverty and unemployment.

In general, the private sector cannot be expected to take the onus of economic growth as it seeks quick returns, which is not always possible in case of investments where the gestation period is too long (for example, investment in infrastructure). It was therefore realised that for transformation of the economy, "the public sector would have to play a crucial role in solving the problems of capital formation, introducing new and advanced techniques of production, extension of social services and overall realignment of production forces."[6] It was also felt that, "a rapid expansion of the economic and social responsibilities of the State will alone be capable of satisfying the legitimate expectations of the people".

Some important tasks the public sector was expected to accomplish are:

- Providing the necessary economic and social overhead capital, including infrastructure conducive to growth for agriculture and industry.
- Developing basic and strategic industries through direct investment for rapid industrial growth.
- Creating job opportunities for the ever-growing number of underemployed[7] and unemployed people.
- Reducing income and wealth disparities in the country.

To fulfil this huge agenda, the government needed a large amount of resources. Hence, the demand for resources continued to grow with the growth in population. This necessitated a hike in expenditure on education, health, family planning and so on.

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[6] First Five Year Plan, Planning Commission, Government of India, Pp.31-32

[7] 'Underemployment' implies that more people are engaged than required to do a certain job (i.e., without them, the job can be comfortably done). To absorb these out of work people, the government needs to create more job opportunities.

Furthermore, the increase in Defence expenditure since the early 1960s also added a new dimension to the demand for resources. Naturally, the government used different means to raise resources, both from domestic as well as foreign (or external) sources. Until the annual plans, the country had to depend heavily on external assistance. But a country cannot depend on external assistance forever. Not only does the country need to be self-reliant, the tax structure must be made more predictable, sustainable, and enable greater citizen accountability, as well as for economic reasons such as taxing excess profits, unearned income, and allocating resources.

As a result, in subsequent plans, it was realised that a greater role should be played by the domestic sector. Among domestic sources, taxation and market borrowing (i.e., borrowing from the public by issuing government bonds) have been the main sources for financing the public sector. However, due to the lower rate of interest on government bonds, market borrowing was not a popular source. Hence, taxation (specifically indirect taxation, which will be discussed later) emerged as a major source of public finance and has continuously grown over time.[8]

## Objectives of Taxation

The major objectives of taxation in the context of India are summarised below:

- To raise sufficient revenue to finance public sector projects without severely affecting savings and investments of the private sector.
- To spread the tax burden (The tem 'tax burden' is detailed in a later section) equitably across different sections of society to reduce income and wealth disparities.
- To restrain 'conspicuous consumption'[9] by affluent sections of society
- To divert investment from luxury goods industries to labour intensive and essential goods industries.
- To mop up excess profits.[10]

[8] As per the IMF classification, there has been a great difficulty to levy income taxes especially from corporations; and that the indirect taxes have tended to shift away from excise and customs, towards VAT. Recently there are issues going on regarding the transition of VAT to GST.

[9] Conspicuous consumption' is the term used to describe consumption in which the consumer derives satisfaction from spending lavishly and ostentatiously for the purpose of attaining 'status' in society or to suggest a high standard of living. It is the flaunting of luxurious goods and services, which the majority of consumers are not be able to afford.

[10] Tax "bads" – from the slogan "Tax Bads, Not Goods" of green lobbies demanding taxes on carbon emissions, pollution – unearned income etc

# Section 3: Distinction between Tax and Non-Tax Revenue

A government generates income or revenue to fund its activities through various sources – through taxes levied on the citizens and businesses and a range of non-tax receipts, which do not come from the citizen's pocket. This chapter tries to demystify the following terms:

1. Revenue (of the government)
2. Tax Revenue
3. Non-Tax Revenue

## What is 'Revenue'?

In general, revenue is income received by an organisation in the form of cash or its equivalent. In the case of the government, 'revenue' is generated from its citizens and organisations. The sources of government revenue can be divided in two categories – 'tax revenue' and 'non-tax revenue'.

## Tax Revenue

In today's context, a tax is a compulsory payment by citizens of a country to the government. It can be viewed as the financial charges the government imposes on its citizens against the facilities provided to them (like education, law and order, sanitation and so on). Generally, there are two types of taxes - Direct Tax and Indirect Tax. Taxes are unrequited in the sense that benefits provided by government (like, education, health, law & order, sanitation and so on) to taxpayers are not normally in proportion to their payments. However, the taxes paid by citizens/businesses are usually not in proportion to the benefits provided by government in terms of education, health, law and order, sanitation.

## Non-Tax Revenue

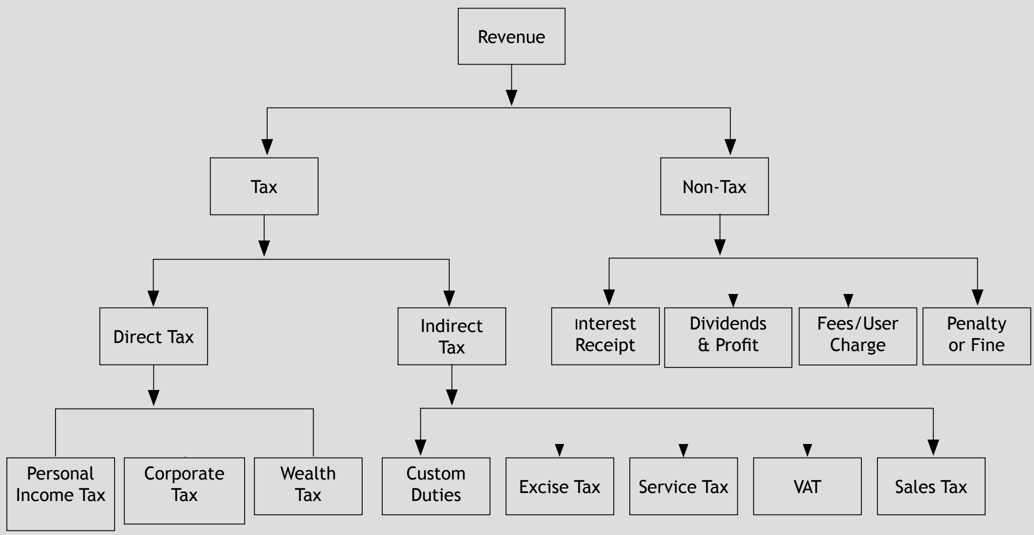
On the other hand, Non-Tax Revenue is defined as all revenue of government other than taxes. This revenue is generated through the following government institutions:

- Various Ministries (e.g., Ministry of Commerce and Industry)
- Various government Departments (e.g., the Central Public Works Department that is responsible for creation and maintenance of capital assets of the Central government)
- Various government Agencies (e.g., the Central Adoption Resource Agency)
- Mining, telephony, and other rental royalties

These institutions i.e., Ministries, Departments and Agencies (collectively termed MDAs) raise revenues from their operations. They can generate non-tax revenue through the following instruments:

- The use of government assets/facilities to provide services to stakeholders (like fees/user charges for public transport), or,
- The enforcement of regulations that require stipulated payments (like interest receipts on loans) to be made to the government through its MDAs. The various components of Tax and Non-Tax Revenue are outlined in chart 1:

**Chart 1: Various Components of Tax and Non-Tax Revenue of Government of India**



# Section 4: Distinction between Direct and Indirect Taxes

Government revenue through taxation can be broadly divided into *Direct Taxes* and *Indirect Taxes*.

## Direct Tax

Direct tax is collected from people or organisations on whom it is directly imposed. ***The burden of direct tax cannot be passed on to any other person or entity*** (In the case of an Indirect Tax, the burden can be shifted). Therefore, the person or entity on whom the tax is imposed is bound to pay the tax.

An example of a direct tax is Personal Income Tax where persons (in the taxable bracket) have to pay the requisite tax for income earned.

## Indirect Tax

Indirect tax is generally imposed on goods or on sales. An example of this would be Sales Tax on a shampoo product, at the rate of 10 percent. ***Indirect taxes can be shifted by the producer (on whose product the tax is imposed) to the ultimate consumer.*** To what extent the burden can be shifted depends on the degree of demand for that product.

In the case of necessary products or essential commodities – for which the common consumers have almost no substitute – a significant chunk of the tax can be incorporated in the final price of the product. This is because the end users cannot stop its consumption or switch over to alternate products (e.g., food grains, vegetables or fuel).

On the other hand, if the tax is imposed on a product that has many substitutes (e.g., HB pencil produced by various manufacturers), the consumers have the choice of buying another product. Hence, the tax burden cannot be shifted much through business transactions. ***[Discussed in detail in Section 15: Some Jargon related to Taxation, see 'Tax Burden']***

# Section 5: Examples of Direct Taxes

Direct taxes are mainly imposed on incomes of companies/corporations or of individuals/persons. Again, these incomes can be generated from possession of property (called Property Tax), wealth (called Wealth Tax) or capital gains (called Capital Gains Tax). The most common or conventional types of Direct Tax in India are:

1. Corporation Tax
2. Personal Income Tax
3. Wealth Tax

## Corporation Tax

This tax is levied on incomes of registered companies/corporations in the country (whether national or multinational/foreign). In India, national companies are taxable in the country on the basis of their aggregate income, irrespective of its source and origin. Foreign companies are taxed only on income that arises from operations carried out in India.

## Personal Income Tax

It is a tax levied on the incomes of private individuals. In India, Personal Income tax is paid to the Central government.

Apart from income tax levied on individuals (personal) and businesses (corporation/companies), taxes are also imposed upon incomes generated from properties (called property tax) and capital gains (called capital gains tax). Generally, income tax is treated as a direct tax where the person or entity is to pay the tax out of their income.

**Property Tax:** For income tax purposes in India, property is considered as a source of income. Therefore, tax is levied on the income from property. Properties usually include buildings, flats, shops and land etc. As per the Income Tax Act, incomes from properties are regarded as one of the heads of income. The amount of tax is calculated on the value of the property being taxed. Property Tax is levied on real estate consisting of buildings or land attached to the buildings. Vacant plots of land without any adjoining building are not liable to be taxed under this head. It will be taxed as income from other sources. The properties that are liable to be taxed as property tax in India are:

- Residential houses (self-occupied or let out)
- Office buildings
- Factory buildings
- Godowns (warehouses)
- Flats
- Shops

**Capital Gains Tax:** Profits generated from the sale of a ***capital asset*** are taxable as capital gains. The tax is applicable in the year in which the sale of the capital asset takes place.

***Capital assets*** are all types of assets (moveable or immoveable) like business stocks, paintings, jewellery and ornaments, houses to family businesses, farmhouses. [11] The capital gain or net profit which is taxable, is basically the difference between the price at which the asset is sold and the price at which it is purchased. A capital gain can accrue due to the sale of a short-term or long-term capital asset.[12]

A capital asset is called a short-term capital asset if it is sold within three years (or 36 months) of the date of purchase. However, in case of mutual funds or company shares, the allowed time duration is one year.

If the time period of sale of a capital asset exceeds three years (in case of mutual funds or company shares it is one year), then it is defined as a long-term capital asset.

## Wealth Tax

Wealth tax is imposed on benefits derived from ownership of property. The tax is to be paid annually on the same property according to its market value each year. The tax is paid irrespective of whether that property yields any income or not.

[11] However, it excludes any physical assets that are traded (exports or imports), personal properties not sold, agricultural land (other than within municipal areas or within 8 kilometres from it) and gold bonds as per the Income Tax Department of India.
[12] The capital gain due to the sale of a short term capital asset is called short term capital gain and capital gain that results due to the sale of a long term capital asset is called long term capital gain.

To be specific, it is the “net worth” (also called net wealth) of the asset of an individual upon which wealth tax is levied. *How is net worth of an asset calculated?* Net worth of an asset is the difference between the value of assets and the liabilities of these assets held by the individual.

In other words, Net Worth = Value of Assets (like house and other physical properties) – liabilities of these assets (like a mortgage or other debt).[13]Since the tax assessee (i.e., on whom the tax is imposed) directly pays the tax, wealth tax is considered a direct tax.

Wealth tax in India is levied under the Wealth Tax Act, 1957 and the Income Tax Department under the Department of Revenue in the Ministry of Finance administers it as well as the rules associated with it.

***What are the assets on which wealth tax can be levied?*** Wealth tax is not levied on *productive assets*. Therefore, investments in shares, debentures, UTI mutual funds etc. are not subjected to wealth tax. The assets chargeable to wealth tax are:

- Guest houses, residential houses, commercial buildings
- Motor cars
- Jewellery, bullion, utensils of gold, silver.
- Yachts, boats and aircraft
- Urban land
- Cash in hand (in excess of 50,000), only for individuals and Hindu Undivided family (HUF)

Wealth taxes are applicable to the following as per the Wealth Tax Act:

- An individual or group of people who own a property
- A company
- A Hindu Undivided Family
- Heir (successor) who is the representative of a deceased person

Income Tax includes all income (except agricultural income) that is levied and collected by the Central government. This tax is then shared with the States.

Income tax was first incorporated in India in 1860. Since then, it underwent a number of modifications and was finally legislated as the Income Tax Act,

[13] Alternatively, net wealth means all assets less loans taken to acquire those assets.

1922, when there was an innovative change made by the All India Income Tax Committee. This was a benchmark year as the organisational history of the Income Tax Department started functioning from 1922 and the administration of income tax came under the direct control of the Central government. This Act was amended in 1961 and the present income tax regime is still following the basic provisions of the Act of 1961.

As per the Income Tax Act 1961, an entity whose total income exceeds the exemption limit is subject to income tax. For instance, it had been announced in Union Budget 2008-09 that incomes between Rs 1.5 lakh and Rs 3 lakh would be taxed at 10 percent, incomes between Rs 3-5 lakh at 20 percent and those earning Rs 5 lakh and above would have to pay income tax at the rate of 30 percent. The tax exemption limit for women was raised from Rs 1.45 lakh to Rs 1.80 lakh while in the case of senior citizens it was increased from Rs 1.95 lakh to Rs 2.25 lakh.

Income tax payments are made in terms of Tax Deducted at Source (TDS), Tax Collected at Source (TCS) and Advance Tax.

**Classification of Individuals:** In the case of income tax, individuals are classified into two groups, purely for administrative purposes. They are:

- Residents, i.e. people residing in India.
- Non-Resident Indians or those not primarily residing in the country.

In order to attract investment by Non-Resident Indians (NRIs) and Indian nationals living abroad, the Income Tax Department has a special provision of concessional tax rate as well as a simplified tax assessment procedure. NRIs are defined as individuals who are Indian citizens or of Indian origin but not residing in the country. A person is believed to be of Indian origin if he/she or either of his/her parents or any of his/her grand parents were born in undivided India.

# Section 6: Examples of Indirect Taxes

As discussed, indirect taxes are the charges levied on goods and services. Individuals or customers/clients indirectly pay these taxes in the form of higher prices. They are chiefly of the following types:[14]

1. Sales Tax
2. Excise Duty
3. Customs Duty
4. Service Tax

## Sales Tax

A sales tax is a consumption tax charged at the time of purchase of certain goods and services. The ruling authority (government) of a country imposes the tax on specific goods and services. Most sales taxes are collected from the buyer by the seller, who remits the tax to a government agency. Sales tax is mostly charged on sales of goods, but there are several services which also come under its ambit.

Before the introduction of Value Added Tax (VAT) in 2002, sales tax was prevalent in the Indian economy. Sales tax levied by the Centre is called Central Sales Tax (CST) and still comprises the most significant source of revenue of the Central government. Sales tax levied by State governments is called State Sales Tax. Sales tax at the State level has been replaced by the State VAT.

Sales tax was found problematic due to its "cascading effect", which increased the tax burden at various stages up to the end user or final consumer.  The term cascade, meaning waterfall, is used here in order to emphasise that the same tax rate is applied at each stage of production. So the burden of the tax falls heavily (like a cascade) on the final consumer.

[14] VAT is discussed in the section on Sales Tax for a comparative view of the two tax regimes. Hence, VAT is not mentioned separately in the classification.

| Table 1: Cascading Effect (or Tax-Upon-Tax) of Sales Tax | | | | | |
|---|---|---|---|---|---|
| Producer/ Manufacturer | Input Cost (in Rs.) | Output Value (in Rs.) | Tax Rate | Selling Price Including Tax Rate (in Rs.) | Tax Burden |
| Producer *A* | _ | 100 | 10% | 110 (100+10% of 100) | Rs.10 |
| Producer *B* | 110 | 150 | 10% | 165 (150+10% of 150) | Rs.15 |
| Producer *C* | 165 | 200 | 10% | 220 (200+10% of 200) | Rs.20 |

The cascading effect problem can be more clearly understood through an illustration: Let us assume there are three producers in an economy – *A*, *B* and *C*. Producer *A* supplies his/her output to *B*, who supplies his/her output to *C*. Suppose the value of producer *A*'s output is Rs.100 and a tax is imposed at a 10 percent rate on output produced by *A*. Therefore, *B* gets the output at Rs.110, inclusive of 10 percent tax (*A* should sell the output to *B* inclusive of tax; otherwise *A* has to pay the tax from his/her own pocket!).

Hence, the input cost of *B* is Rs.110. (The output of *A* is used as input by *B* in his/her production). Now *B* carries out further processing and let us assume that the value of *B*'s output is Rs.150. (Producer *B* could also settle his/her value of output to say Rs.160 or Rs.170 or even more depending upon profit and conversion considerations (but let us assume *B* settles at Rs.150 only).

Now, while selling the product to *C*, *B* will set the price of his/her output incorporating tax again at the rate of 10 percent. Thus, *C* will get the item at Rs.165 (150+10 percent tax on Rs.150). Again, suppose producer *C* decides his/her selling price at Rs.200. But, he/she will sell the product at Rs.220 (including the 10 percent tax rate, i.e., Selling Price = Rs.200+10% of Rs.200), and not at Rs.200.

As the stages of production and/or sales continue, each subsequent purchaser has to pay tax repeatedly on the output that has already been taxed. The important point is that the same product is being taxed more than once at different stages of production and the problem is that the tax burden on the final consumer is enormous. Moreover, the compliance cost would be very high.

VAT has been somewhat of an improvement, removing to an extent the cascading or “tax-on-tax” effect.

In the previous example, ‘value added’ by *B* is only Rs.50 (150–100). To clarify, the price (value) set on the final product by producer *B* is Rs.150 (value of producer *B*’s output), and he/she has purchased input at Rs.100 (value of output of *A*) from producer *A*. [Note: It can be argued that *B* sells at Rs.165 and purchases from *A* at Rs.110 so the difference could be taken as well. This is basically the difference between selling prices of producers. However, this is another method which is not being emphasised at the moment. The differences between the value of outputs of producer *B* and producer *A* are being calculated (i.e., taking the output values independent of taxes] as illustrated in tables 1 and 2. Hence, the value addition on the product by *B* is the difference between the output value of *B* (which is Rs.150) and the output value of producer *A* which is Rs.100.

Now, the tax on producer *B* would be only Rs.5 (i.e., 10% of Rs. 50) while the tax paid in reality was Rs. 15 (10% of 150). [Note that in the former case, tax is paid on the ‘value added’ while in the latter, it is paid on ‘selling price’ as well as the differences of the tax burden in the two cases]. For practical purposes, VAT can be calculated in the following manner:

Input tax for *B* is Rs.10 (i.e., tax on output of A)

Output tax for *B* is Rs.15 (i.e., 10% of Rs.150)

VAT = Output tax - Input tax = 15-10 = 5

In VAT, the idea is that *B* will pay tax on only Rs 50, i.e., value added by him. It does not matter whether a product passes through 10 or 20 stages or even 100 stages, as every producer will pay tax only on ‘value added’ by him to the product and not on the selling price of the product. Tables 1 and 2 compare the ‘tax burdens’ of Sales Tax vis-à-vis VAT.

| Table 2: Value Added Tax | | | | | | |
|---|---|---|---|---|---|---|
| Producer/ Manufacturer | Input Cost (in Rs.) | Output Value (in Rs.) | Value Addition (in Rs.) | Tax Rate | Selling Price Including Tax Rate (in Rs.) | Tax Burden |
| Producer A | _ | 100 | _ | 10% | 110 | Rs.10 |
| Producer B | 110 | 150 | 50 (150-100) | 10% | 155 (150+10% on Rs.50) | Rs.5 |
| Producer C | 155 | 200 | 50 (200-150) | 10% | 205 (200+10% on 50) | Rs.5 |

Some of the chief advantages of VAT over sales tax are:

- Burden of tax on final consumer is much less.
- It avoids repeated tax on the product (where the same tax rate is already included). Therefore, burden on producers is also less.
- It reduces compliance and administrative costs.
- It reduces the tendency of tax evasion due to reduced tax burden. Hence, government revenue is also expected to increase.

Value Added Tax in India was initiated at the Central level for a particular group of commodities through the Modified Value Added Tax (MODVAT) scheme on March 1, 1986. It was converted to Central Value Added Tax (CENVAT) in 2002. Likewise, State Sales Tax has been replaced by State VAT. Going ahead with its tax reforms, the government is set to roll out the Goods and Services Tax (GST), which would give States the right to tax goods up to the retail stage (currently restricted to the manufacturing stage).

## Excise Tax

Excise taxes are based on quantity, not value, of the product purchased. More commonly known as Excise Duty, it is one of the most well-known forms of taxation in the country. Any manufacturer of excisable products is liable to pay this tax, levied on a wide variety of manufactured commodities. For example, a fuel excise (user tax) is often used to pay for public transportation, especially for roads and bridges and protection of the environment.

It is an important source of government revenue and accounts for the largest single financial source for both the Central as well as State governments. Manufacturers are required to pay excise taxes before goods leave the factory. The State governments are liable to levy excise duty on a few commodities including liquor.

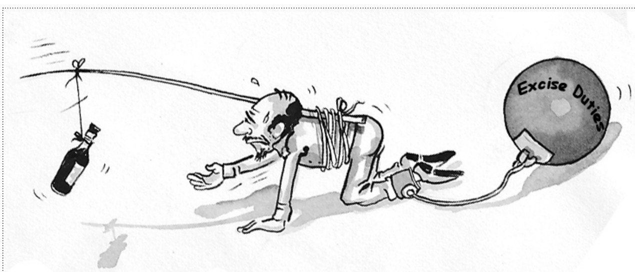
Excise duties are often levied at higher rates on goods, the consumption of which are believed to have adverse effects on public health or the environment. High excise is used to discourage alcohol consumption. Similar taxes are imposed on tobacco, pornography, which are collectively referred to as "sin taxes". Carbon tax is levied on consumption of carbon-based non-renewable fuels such as petrol, diesel-fuel, jet fuels and natural gas with the objective of reducing the release of carbon into the atmosphere.

## Customs Duties

It is a kind of "trade tax" levied on imported and exported goods. Customs duty is one of the most important tariffs in India, regulated under the Customs Act, 1962. Apart from revenue considerations, a major purpose of this tax is prevention of illegal export and import of goods. The rates of the custom duty levied on the imported and exported goods are assigned in the Act.

## Service Tax

This is a tax collected from service providers. The government taxes them on *Gross Amount* charged from clients. It is an indirect tax as it can be recovered (i.e., tax burden can be passed on to the service receiver by the service provider) in course of business transactions. The Service Tax rate was 5 percent when it was introduced in 1993-94 after which the rate was raised to 8 percent in 2003. At present, the rate is 10.2 percent.



# Section 7: Which Taxes are Progressive?

Generally speaking, direct taxes (i.e., Corporate Tax, Personal Income Tax, and Wealth Tax) reflect the taxpayer's *Ability-To-Pay*. That is why the tax paid by the rich and those by other income groups vary. In this context, direct taxes can be termed as *progressive* in nature (Box 1) vis-à-vis indirect taxes.[15]


Indirect tax on any good or service affects the rich and poor alike. Both low and income users/consumers have to pay the same tax rate for the goods or services provided. Hence, indirect taxes tend to be *regressive* in nature (Box 1).

**Box 1: Progressive, Regressive and Proportional Taxation**

Progressive Tax: In the case of a progressive tax, the tax rate goes up as the amount to be taxed increases. In simple terms, it imposes a greater tax burden on the rich than on the poor. Progressive taxes attempt to reduce the tax incidence of people with a lower ability-to-pay as they shift the incidence disproportionately to those with a higher ability-to-pay.

For example, a taxing authority might levy a tax of 10 percent on the first Rs.10,000 of income and increase the rate by, say, 4 percent for each Rs.10,000 increment up to a maximum of 50 percent on all income over Rs.60,000. A progressive tax often uses higher rates on relatively greater incomes.

[15] Depends on rates, bands, exemptions, incentives etc. But *ceteris paribus* (with other things being equal or held constant), direct taxes are more progressive.

***Regressive Tax:*** The opposite of a progressive tax is a regressive tax. For example, a value-added tax (VAT) or sales tax on food and other essentials such as clothing, transport and residential rents can be regressive. The reason is that it tends to take up a higher percentage of the budget of a person or family with a lower income. In such cases, a lower income person is subject to the same tax rate as a much higher income person. A person earning Rs.10,000 a month and paying a 10 percent sales tax would bear a heavier burden than someone earning Rs.50,000 a month and paying the same tax rate on sales.

***Proportional Tax:*** Between progressive and regressive tax, there exists a type commonly known as proportional tax. In the case of proportional tax, the tax rate is fixed as the amount subject to taxation increases. Even if the subject of taxation increases (like income, property and so on) the tax rate is flat. There is a debate on whether it is progressive or regressive in nature though the general perception is that it is regressive.

# Section 8: Methods of Tax Collection in India

The Central Board of Direct Taxes (CBDT) under the aegis of the Finance Ministry provides the necessary inputs for policy and planning of direct taxes in India. It is also responsible for administration of direct tax laws through the Income Tax Department. The officials of the Board deal with matters relating to levy and collection of direct taxes.

The ***Central Board of Revenue*** served as the apex body for administration of taxes and was formed as a result of the Central Board of Revenue Act, 1924. The Board was initially in charge of both direct and indirect taxes but as the administration of taxes became too heavy, it was split up into two. Hence, the Central Board of Direct Taxes (CBDT) and Central Board of Excise and Customs (CBEC) came into effect on January 1, 1964.

CBDT, headed by a chairperson, (who is also an ex-officio Special Secretary to the Government of India) is in charge of all issues pertaining to direct taxes. There are six CBDT members in charge of different functional areas relating to direct tax, they being: Income Tax; Legislation and Computerisation; Revenue; Personnel and Vigilance; Investigation; Audit and Judicial.

# Section 9: Distribution of Taxes between Centre and States

There are three tiers of government in the Indian governance structure. These are: Union Government (at the Centre), State governments (in the respective States), and Local Bodies/local self governments (including Village Panchayat, Panchayat Samiti, Municipalities and Municipal Corporations) at the local level. Since the different layers of government operate simultaneously, confusion and financial conflict are a very natural outcome. In order to minimise such disputes there are guidelines or rules regarding the revenue and expenditures of the tiers of governance.

The system or organisation of such rules is called “federal finance”, based on the definition of “federation” denoting a system of government in which there is a division of powers and functions between the different levels. Therefore, federal finance is a system of the financial relationship between different layers of governments (particularly Centre-State). The financial relationship between the Union and State governments is enshrined in the Constitution of India.

The focus of this relationship is on ***distribution of authority*** between the Centre and States regarding:

- How to raise tax and non-tax revenues
- How to spend tax and non-tax revenues in the economy to enhance growth and development

Nonetheless, there are certain issues such as transfer of funds from Centre to State governments that need to be continuously monitored keeping in mind the regional needs. For this purpose, there is a provision for setting up of the Finance Commission every five years as per the Constitution. Based on its recommendations, the Central government decides the allocation of funds to different States.

The Constitution has made a clear distinction between the revenues of the Union and State governments, articulated in the form of three lists – Union, State and Concurrent.

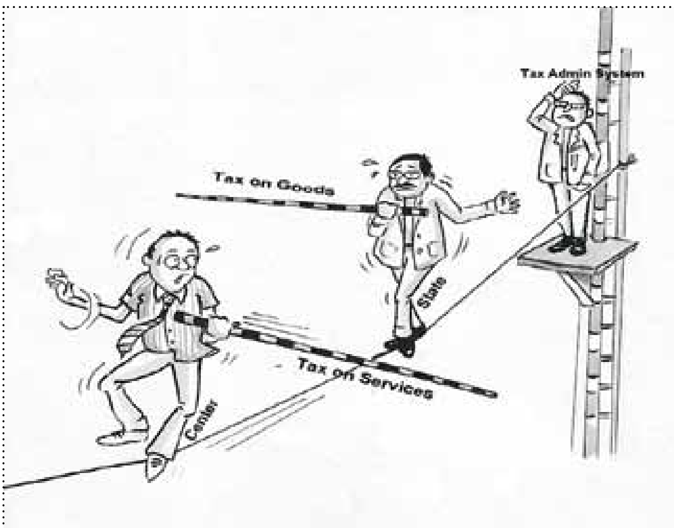
1. ***Union List:*** It includes revenue sources that are the sole privilege of the Central government (e.g., Corporate Tax, Tax on Capital values

of assets, which is property, or Capital Gains Tax excluding land, and Customs Duty). No part of the revenue collected through these taxes is transferred to the State governments.

2. ***State List:*** State list includes sources of revenue that are the sole privilege of State governments (e.g., stamp duties)
3. ***Concurrent List:*** It includes those areas where the Central government as well as State governments can pass laws to generate revenue.

**Distribution of Tax Revenue:** The revenue collected from taxes is distributed between the Centre and States in the following manner:

- Central Tax Revenue only for Central Government – Central government levies taxes and collects the revenue from such taxes (e.g., Corporate Tax, Tax on Capital values of assets, which is property, or Capital Gains Tax excluding land, and Customs Duty). No part of the revenue collected through these taxes is transferred to the State governments.
- Central Tax Revenue shared with States – Central government levies taxes but a part of the revenue is shared with States (e.g., Income Tax and Central Excise Duty).
- Central government levies taxes but entire revenue is given to the States (e.g., Wealth Tax and Real Estate duty or property tax).
- State Tax Revenue only for States – State governments levy and collect tax revenue (e.g., stamp duty).



**Box 2: Important Taxes levied by Centre, State Governments and Local Bodies**

The Central government can levy the following taxes:

- Income tax (except tax on agricultural income, falling under State governments)
- Corporate tax
- Excise duty (excluding that on narcotics and alcohol, which can be levied by State governments)
- Customs duty
- Central Sales Tax (slated to be replaced by Goods and Services Tax)
- Service Tax
- Wealth Tax (levied by the Centre but entire revenue collected is given to States. The other such tax is Real Estate Duty or property tax).

State governments have been vested with the power to levy the following taxes:

- Land Revenue (a levy on land used for agricultural/ non-agricultural purposes)
- Stamp Duty (a duty on transfer of property)
- State Sales Tax (tax on intra-State sale of goods) [This has been replaced by the State Value Added taxes or State VAT)
- State Excise (a duty on manufacture of alcohol)
- Duty on Entertainment and Tax on Professions.

Local Bodies have been empowered to levy: tax on properties (buildings, etc.), Octroi (tax on entry of goods for use/consumption within areas of the Local Bodies), tax on markets and tax/user charges for utilities like water supply, drainage.

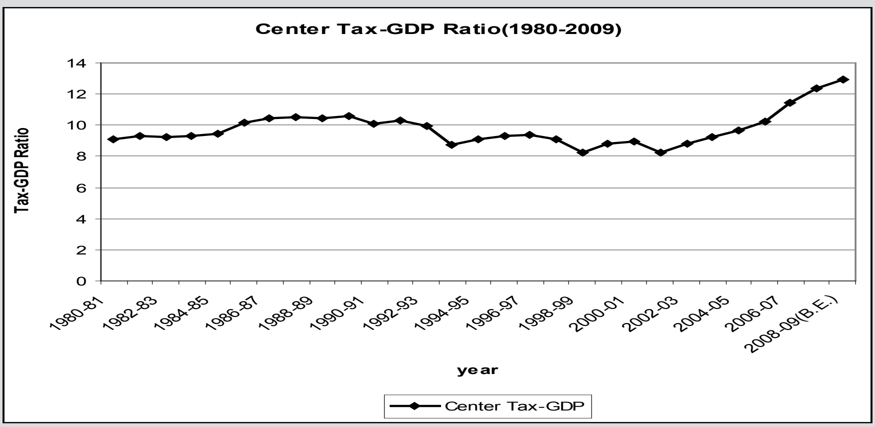
# Section 10: Tax-GDP Ratio

Tax-GDP ratio is an indicator of fiscal performance. The higher the ratio, the better is the tax collection higher the tax revenue. Charts 2 & 3 show trends of tax revenues of the Centre, States and Total (Centre-State combined). It is observed that even after liberalisation, the Central Tax-GDP ratio has not been impressive though a relatively better trend emerged after 2003-04.[16]

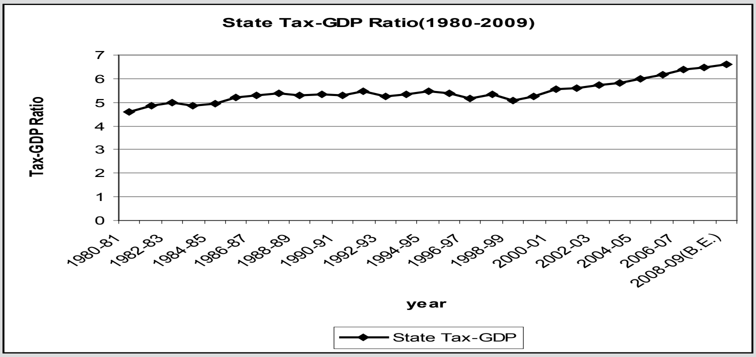
The State Tax-GDP ratio also shows a similar trend. It was stagnant between 5-6 percent up to 2003-04 after which there was a marginal rise. The total Tax-GDP ratio therefore reflects an increasing trend (marginal) after 2003-04. [Chart 2: Tax-GDP ratio of Centre, State and Total (Centre-State Combined)]

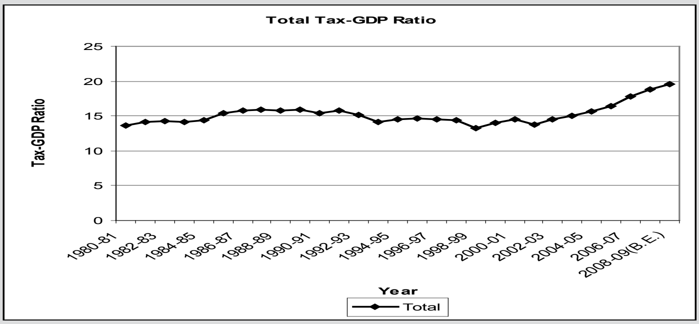
However, if we compare the Tax-GDP ratio with other international countries, India ranks very low. [Chart 3: Comparison of Tax-GDP Ratio of India with Select Countries]

**Chart 2: Tax-GDP ratio of Centre, State and Total (Centre-State Combined)**



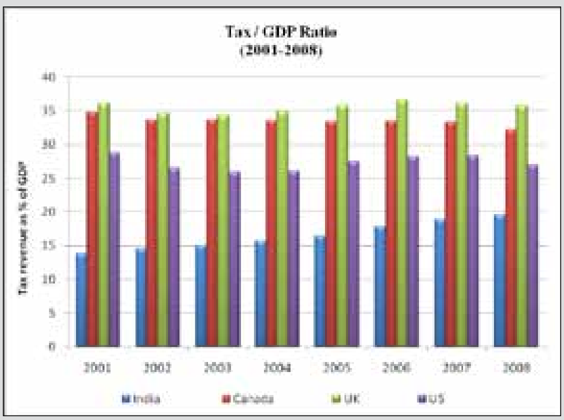

[16] After liberalisation, there was a reduction in the rates of customs duties and excise. This was specifically done to open the economy to worldwide competition. Consequently, the Tax-GDP ratio for India declined. As highlighted in the report of the Advisory Group on Tax Policy and Tax Administration for the Tenth Five Year Plan, May 2001 (between 1990 and 2000), the decline in Tax-GDP ratio has been 1.9 percentage points, primarily reflecting the Centre's revenue loss.




Source: Based on Indian Public Finance Statistics, 2008-2009

## Chart 3: Comparison of Tax-GDP Ratio of India with Select Countries




Source: World Development Indicators, World Bankv

# Section 11: What are Tax Exemptions?

In any tax system, there are provisions for tax exemptions for certain organisations/individuals or other items/entities taxable under it. Due to tax exemptions, a potential taxpayer might get a complete relief from tax, pay tax at a lower rate, or pay tax on a part of the items subject to tax.

The argument in favor of tax exemptions is not to overburden taxpayers as those who face a huge tax burden might try to look for ways and means to evade it. As a result, tax revenue might fall. On the other hand, too many tax sops might also lead to a loss of revenue.

In the Indian context however, the latter is more prominent. There is a plethora of exemptions/deductions under the Central government tax system. Consequently, the tax base is also low. As reflected in Table 3, the total amount of tax revenue foregone due to exemptions/incentives/deductions under the Central tax system has been estimated to increase from Rs.4.14 lakh crore in 2008-09 to Rs.5.02 lakh crore in 2009-10. The amount of revenue forgone as a percentage of aggregate tax collection is also substantial.

| Table 3: Revenue Loss due to Tax Exemptions in India | | | | |
|---|---|---|---|---|
| Items | Revenue Forgone in 2008-09 (in Rs crore) | Revenue Foregone as % of Aggregate Tax Collection in 2008-09 | Revenue Foregone in 2009-10 (in Rs crore) | Revenue Foregone as % of Aggregate Tax Collection in 2009-10 |
| Corporate Income Tax | 66901 | 11.08 | 79554 | 12.60 |
| Personal Income Tax | 37570 | 6.22 | 40929 | 6.48 |
| Excise Duty | 128293 | 21.25 | 170765 | 27.04 |
| Customs Duty | 225752 | 37.39 | 249021 | 39.43 |
| Total | 458516 | 75.95 | 540269 | 85.56 |
| Less (Export Credit Related) | 44417 | 7.36 | 37970 | 6.01 |
| Grand Total | 414099 | 68.6 | 502299 | 79.5 |

Source: Receipts Budget, Union Budget 2010-11, Government of India.

# Section 12: Institutions dealing with Taxation in India

Taxation aspects in the country are primarily dealt with by the *Department of Revenue* under the Ministry of Finance, Government of India. The Ministry's official website: ***http://finmin.nic.in/*** lists five Departments as working under it. These are:

- Economic Affairs
- Expenditure
- Revenue
- Financial Services
- Disinvestment

The Department of Revenue operates under the "overall direction and control of the Secretary (Revenue)" and deals with all matters regarding Direct and Indirect Taxes through the two statutory boards, each headed by a Chairman (who is also ex-officio Special Secretary to GoI). The boards are:

1. Central Board of Direct Taxes (CBDT)
2. Central Board of Customs and Central Excise (CBEC)

## Central Board of Direct Taxes (CBDT)

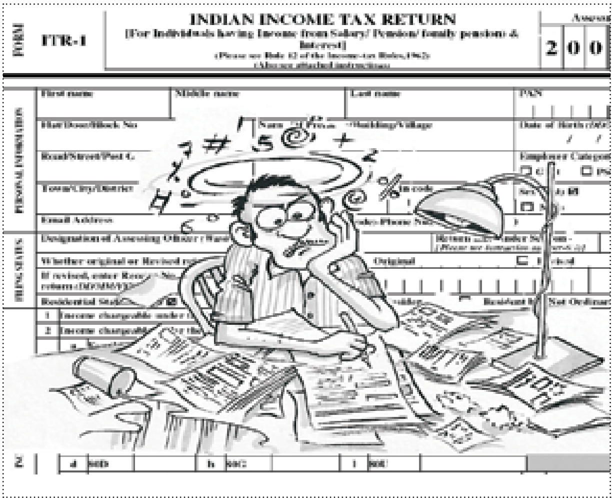
As per the Revenue Department, CBDT has the sole authority to deal with all matters relating to various direct taxes in India. It was given this legislative power on 1st January 1964. The primary activities of CBDT are as follows:

- To provide necessary inputs for policy and planning of direct taxes
- To administer direct tax laws through the Income Tax Department

## Central Board of Customs and Central Excise (CBEC)

The functioning of this legislative authority is as follows:

- Formulation of policy concerning levy and collection of Customs and Central Excise duties
- Prevention of Smuggling




❖ Administer matters relating to Customs, Central Excise and Narcotics (to the extent under its purview).

The two boards were constituted under the Central Board of Revenue Act, 1963. CBDT has six members and CBEC has five members. The members are also ex-officio Additional Secretaries to Government of India.

# Section 13: Tax Reforms in India

This section presents a brief discussion on what kind of thinking or economic philosophy has driven the mainstream economists and policy makers at the Centre in the last two decades. In the era of pro-market reforms in India started since 1991, a number of reforms have dealt with the country's tax system; many of these have been based on the Dr. Raja Chelliah Committee Report. According to such thinking, in the early 1990s, the tax rates were very high and taxable entities were much less. Due to higher tax rates, the tendency of tax evasion was higher leading to loss of revenue. Hence, it was felt that rates should be reduced and the number of taxable units increased.

The Chelliah panel's major recommendations are as follows:

- Rationalisation of entire tax structure
- Increasing the amount of taxable entities (i.e., increasing the tax base)
- Lowering tax rates
- Value Added Tax; and
- Simplification of tax laws

Over the years, most of its recommendations have been implemented, at least at the Central level. Notwithstanding the reduction in marginal tax rates, revenues from personal and corporate income taxes increased after the reforms were initiated. Thus, the share of revenue from direct taxes as a proportion of GDP showed a substantial increase (from less than 14 percent in 1990-91 to 24 percent in 1997-98).

According to some proponents, the increase in tax revenue was partly due to the Voluntary Disclosure of Income Scheme (VDIS), introduced in 1997-

98 to provide an opportunity to individuals, companies and NRIs to declare concealed incomes and assets. There were reductions in the Wealth Tax rate and a basic exemption given to Gift Tax (from Rs.20,000 to Rs.30,000). Moreover, both average and peak tariff rates were drastically reduced while Union excise duties were simplified and rationalised – the number of rates were reduced. A tax on specific services (telephones, non-life insurance and stock brokerage) was introduced in 1994-95 and subsequently extended to cover a large number of services.

The Centre set up a Task Force on Tax Reforms in September 2002, and subsequently, a Task Force on Implementation of the Fiscal Responsibility and Budget (FRBM) Act , 2003 – both of which were headed by Dr Vijay Kelkar. The Kelkar Committee report on taxation made a broad list of recommendations. [17]

(a) Regarding Personal Income Tax, it suggested:[18]

- Below Rs.100,000 Income – no tax
- For incomes between Rs.1,00,000-Rs.4,00,000 – 20 percent tax
- For incomes above Rs.400,000-Rs.60,000 +30 percent tax of the Income in excess of Rs.4,00,000/-

**Table-4: Recommendations of Kelkar Committee**

| **Income level (in Rs.)** | **Tax rates** |
|---|---|
| Below 1,00,000 | **NIL** |
| 1,00,000- 4,00,000 | 20 per cent of the Income in excess of Rs.1,00,000/- |
| Above 4,00,000 | Rs.60,000/- plus 30 per cent of the Income in excess of Rs.4,00,000/- |

URL: finmin.nic.in/**kelkar**/Full_**Report**.pdf (Pp 54-55)

[17] As per the Kelkar Committee Report: "…In 1973-74, the tax rates of 10 per cent and 20 per cent were applicable for incomes up to Rs.10,000 and Rs.20,000 respectively. The corresponding inflation adjusted income levels are Rs.1,00,000 and Rs.2,00,000 in 2001-2002. Thus, the existing corresponding income levels of Rs.60,000 and Rs.1,50,000 are substantially lower than the inflation-indexed levels — thereby resulting in an increase in the real tax liability. Historically, while the top marginal rates of tax have been reduced, the tax liability at the middle has indeed increased. This has, not surprisingly though, has given rise to the problem of "the missing middle". If the full effect of the "Laffer Curve" has to be realised, it is not only necessary to have an optimal enforcement strategy but also ensure that the benefits of a tax cut apply to all class of tax payers — rather than be restricted to a handful of taxpayers at the top end. This is possibly achieved by broad basing the tax slabs and we recommend accordingly". (pp-54-55)..URL: finmin.nic.in/kelkar/Full_Report.pdf

[18] See pages 54-55 of the Kelkar Committee Report, URL: finmin.nic.in/kelkar/Full_Report.pdf

(b) Regarding Corporate Tax, it suggested:

- Reduction in tax rate from existing levels of 36.75 percent to 30 percent for domestic companies
- Reduction in tax rate to 35 percent for foreign companies.

(c) Three-rate basic Customs Duty structure (raw materials 5 percent, intermediate goods 8 percent and finished goods 10 percent);

(d) Service Tax levied in comprehensive manner, leaving out only few services (public utilities and social services) to be included in a negative list

(e) The Income Tax Department should provide easy access to taxpayers through Internet and e-mail

(f) The Department should extend facilities such as TeleFiling and TeleRefunds. It should design special programmes for retired people, low-income taxpayers and other such groups with special needs who cannot afford the expensive services of tax consultants

(g) Gradual moving over the destination-based, consumption-type VAT at the State level.

The decision to introduce VAT was first discussed at a conference of State Chief Ministers and Finance Ministers in 1999 and the deadline of April 2002 was decided for its roll out. However, the introduction of VAT was postponed to April 2003 and, successively, to April 2005, mainly due to lack of administrative preparedness of some States. Moreover, there was no agreement between the Central and State governments on the system of compensating States that incur revenue loss as a consequence of VAT implementation. The agreement was finally reached on November 2, 2004, after all States (except three) declared they were ready with the necessary legislation(s).

The sales taxes of the States was hence gradually replaced with the more uniform VAT since April 2005, based on a blueprint finalised by the Empowered Committee of State Finance Ministers. (VAT has been further streamlined, with GST poised for introduction in India).

# Section 14: Non-Tax Revenue in India

As already described, Non-Tax Revenue is the government revenue that comes from various sources other than taxes and is generated through government institutions, i.e., Ministries, Departments and Agencies (MDAs). The MDAs can raise non-tax revenues:

- Through use of government assets/facilities to provide services to stakeholders (like fees/user charges for public transport);
- Through enforcement of regulations that require stipulated payments to be made to government through its MDAs ( like interest receipts on loans)
- Mining Royalties and other royalties of use of mobile phone spectrums, TV and radio broadcasting spectrums.

Major Components of Non-Tax Revenue of the Indian government are:

- ***Interest receipts on loans:*** Interest receipts is a major non-tax revenue of the Central and State governments. The Central government collect interest on loans from State governments, Union Territory governments[19] and other sources (the most important being Railways). States, on the other hand, collect interest receipts from local bodies, cooperative societies and various State Public Sector Undertakings (PSUs).
- ***Dividends and Profits from Public Sector Enterprises/ PSUs:*** The major part of dividends and profits come from PSUs. Other sources are Reserve Bank of India, nationalised banks and financial institutions.
- ***Grants-in-Aid:*** A grant-in-aid is money coming to central government for a specific project from external sources. It may also be foreign aid (purely unconditional loan and no obligation to repay).

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[19] India is divided into 28 States and seven Union Territories. The States have their own governments while the UTs are administered by the Central government or it can empower with a legislature as in the case of Puducherry.

- ***Fees/User Charges:*** Payments collected for some of the services delivered by government departments. The sources of revenue come broadly from:
  - General Services (Public Service Commission & other administrative services like defence, police services. To illustrate further, the receipts of 'Public Service Commission' mainly represent examination fees etc. of the Union Public Service Commission and Staff Selection Commission).
  - Social Services (medical & public health, education, sanitation, social security).
  - Economic services (fees/user charges are generated from economic activities like fisheries, crop husbandry, power & petroleum).
  - Exhaustible or renewable natural resources to which private property rights are not assigned (i.e., which are public goods) is another important source of non-tax revenue, the most important example being mineral exploration for which the government receives royalty and rental payments. In many Indian States, this is the most important source of non-tax revenue. Penalties and fines are some other sources of non-tax revenue.

# Section 15: Some Jargon related to Taxation

## Tax Burden

The burden of tax finally falls on those who ultimately pay it. Take the example of a commodity that is priced at Rs.100 in the market, with a tax of Rs.50 imposed on it. A seller usually would not be willing to pay the entire tax amount out of his/her own pocket. So, the price of the product is lowered to Rs.70 and the consumer believes that something that was earlier selling for Rs.100 will now be available for Rs. 30 less. So where is the trick?

Well, the seller now says there is also a Rs.50 tax on the product charged by the government and the buyer ends up paying Rs.70 plus Rs.50 = Rs.120. The consumer who was supposed to pay only Rs.100 for the product ends up paying Rs.20 more. The seller pays the difference between the price paid by the consumer and the actual price after tax for the commodity from his/her own pocket (i.e., after tax price of the good is Rs.100+Rs.50 = Rs.150). The consumer pays Rs.120 and the seller pays the difference (Rs.150 minus Rs.120 = Rs.30).

Thus, the consumer of the product is made to bear a part of the tax. [Note: The tax burden for the consumer here is Rs.20 and for the seller it is Rs.30]. This is called "shifting" of the tax burden. In many cases, the entire tax burden is passed on to the end user who may pay the entire price of the product after tax i.e., Rs.150.

*The extent of shifting of the tax burden* depends on the price elasticity of demand[20] or price sensitiveness of the product. If the product is price-sensitive, its demand might fall abruptly because of the price hike due to tax shifting. Taking the previous example above, if the product is price-sensitive, the demand would fall abruptly due to the price hike (inclusive of taxes, say Rs.70+Rs.50 = Rs.120) and the seller might have to reduce the price further to Rs.60 instead of Rs. 70. The more price-sensitive the

[20] Price elasticity of demand measures the responsiveness of the quantity demanded of a product to a change in its price. It gives the percentage change in quantity demanded of a product in response to a one percent change in price of that product, given that all other determinants of the product are constant.

product, the less would be the power of the producer to shift the tax burden.

On the other hand, if the product is a necessary commodity like potatoes or salt, the seller can pass the entire tax burden on to the consumer. In such cases, the seller can even sell the product to the final consumer at Rs.150 (Rs.100+Rs.50). Hence, the power to shift the tax burden by the seller depends on the demand elasticity of the product with respect to its price.

## Compliance Costs

Although governments spend money on tax collection activities, some costs (particularly for keeping records and filling out forms) are borne by businesses and private individuals. Detailed records of all input tax and output tax have to be kept to facilitate completion of tax returns, and may also necessitate employing someone skilled in the field. Tax filing and administration consists of a number of factors like data requirements, system of tax rulings and interpretations, procedures for registration, filing and processing of tax returns, tax payments and refunds, audits. These are collectively called compliance costs. More complex tax systems tend to have higher costs of compliance, a fact which can be used as the basis for arguments in favour of tax simplification. A simplified, easy-to-understand tax system can reduce compliance costs to a greater extent.

## Taxable Capacity

Taxable capacity refers to the extent to which households and firms can pay a tax and a fiscal (government) authority can collect it.

## Tax Compliance

This is a positive term when the individual or the firm meets all their tax obligations and works within the law. Opposite of abusive tax avoidance.

## Taxable Income

This means the income subject to taxation. Personal and other allowances are deducted from total pre-tax income to determine what is taxable.

## Tax Evasion

Tax evasion refers to reduction of one’s own tax burden through inaccurate statements of income, which are relevant to tax liability. Tax evasion is criminal and unlawful; these practices are illegal, whereas 'tax avoidance' is the legal utilisation of the tax regime to one's own advantage to reduce the amount of tax that is payable by means that are within the law.(There are number of definitions used by different academic/research organisations, but it is unambiguous that Tax Evasion is  a illegal mean to avoid taxes)

## Tax Farming

It pertains to the delegation of rights to collect taxes. *It is the procedure through which responsibility for tax revenue collection is assigned to private citizens or private groups.*  As a result, private tax collectors are often given the freedom to raise more than the quota prescribed by the government. It dates back to ancient Egypt, Rome, Britain and Greece where the method was considered very effective for tax collection. However, one problem plagues the system; there is a tendency among tax farmers of abusing their power to collect taxes and the taxpayer bearing the brunt of it. A classic example are the *publicani* (public tax collection agents/public contractors) of ancient Rome, described by chroniclers as being very abusive tax farmers. Only when the system included checks and balances for tax farmers as well as the taxpayer did the system evolve into a more successful one.

## Tax Harmonisation

Tax harmonisation is the *standardisation of tax rates, tax rules and tax definitions* through a number of States or countries. In other words, it is a process of making taxes *similar* in a region so that trade transactions are less disrupted as well as to minimise the administrative cost related to tax collection.

## Tax Haven

An economy offers tax haven(s) with very low taxation rates in order to attract businesses and individuals for the purpose of minimising its tax liability. [21]The country or territory doing so benefits from the influx of currency and the consequential commercial activity. In the West, most of these havens are small islands or countries off the coast of the United

[21] Especially for non-resident incomes (this is the vicious nature of a tax haven, the low rates apply to foreign businesses and not domestic ones).Second feature is 'secrecy' as when the foreign capital can come in secretly and leave little traces, it creates a space where international tax evasion is hard to detect. Examples are – unpaid corporate taxes for mispriced imports & exports, or unpaid capital gains tax for rich persons' assets held in a tax haven.

States – the Bahamas and Virgin Islands. In India, the Special Economic Zones (SEZs) could be considered discreet examples of tax havens.

## Tax Threshold

Tax threshold is the income level at which income becomes liable to taxation.

## Tax Unit

Tax unit refers to the person or group subjected to taxation (e.g., a single person, a married couple or a household).

## Tax Buoyancy

Tax buoyancy is another important concept regarding taxation. It measures percentage change in tax revenue due to a one percent change in the tax base. More specifically:

Tax Buoyancy = Change in Tax Revenue (percent)/Change in Tax Base (percent)

GDP is usually taken as the tax base. However, other bases are also possible (aggregate consumption as the base for sales taxes or total imports as the base for tariffs) The revenue can be total tax revenue or from any particular tax.

## Secrecy Jurisdiction

This is a country or a territory, which creates a secretive financial and legal structure, purposefully aiding tax and regulatory abuse. There are three types of secrecy: 1) Swiss-style banking secrecy codified in the law, 2) Jersey-type trust laws, and 3) Cayman Islands and Mauritius type lack of any effective reporting and disclosure requirements for accounts and International Business Corporations.

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Centre for Budget and Governance Accountability (CBGA) promotes transparent, accountable and participatory governance, and a people-centred perspective in the policies shaping up the government's budgets. CBGA's research on public policies and budgets, over the last eight years, has focused on the priorities underlying budgets, quality of government interventions in the social sector, responsiveness of budgets to disadvantaged sections of population and structural issues in India's fiscal federalism. Research on these issues has laid the foundation for CBGA's efforts pertaining to training and capacity building on budgets (mainly with the civil society organisations in the country) and policy advocacy with important stakeholders. Please visit the website www.cbgaindia.org to know more about the organisation.

**About Christian Aid**

Christian Aid is a British and Irish charity working to tackle the causes of poverty and injustice in some of the world's poorest countries. It supports local communities to find their own solutions to the problems they face. It is unequivocal about working where the need is greatest, regardless of race or creed. Christian Aid believes that Poverty is an outrage against humanity. It robs people of dignity, freedom and hope, of power over their own lives. Christian Aid has a vision – an end to poverty – and it believe that vision can become a reality. Christian Aid's essential purpose therefore is to expose the scandal of poverty, to help in practical ways to root it out from the world and to challenge and change the systems that favor the rich and powerful over the poor and marginalized.

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**Centre for Budget and Governance Accountability**
A-11, Second Floor, Niti Bagh
Khel Gaon Marg
New Delhi - 110049, India
Phone: +91-11-41741285/86/87
Email: info@cbgaindia.org
Web: www.cbgaindia.org

CBGA
Centre for Budget and Governance Accountability

What is Tax?
What is the significance of Taxation in the Indian Context?
What is the distinction between Tax and Non-Tax Revenue?
Which Taxes are Progressive?

These are just some of the questions to which you will find helpful answers in this easy-to-use primer.