

Full Length Research Paper

A study on direct taxation in India

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Taxation is a major source of revenue for the Government. It is also a means of economic transformation and socio-economic cohesion. Taxation policy of a country has to play a vital role, particularly, by utilizing this weapon to the best advantage of the national economy. Specially, in a developing country like India, taxation has been used to promote multiple objectives such as to increase the rate of domestic savings, reduce inequalities of income and wealth and to maintain price stability. Revenue from taxes has provided a big support to the Government finances. Revenue from direct taxes is increasing day by day. Direct taxes are preferred to indirect taxes because they are more

equitable, administratively effective and can be related to individual's ability to pay. Income-tax is the oldest tax in the direct taxes and has an important place in the direct tax revenue. Besides, agricultural income-tax and professional tax are also very important in the matter of economic stabilization. So, these taxes also play an important role in Indian direct taxes. This paper is an attempt to analyze and interpret the importance of taxation, especially direct taxation in India.

Keywords: Direct taxes, Income-tax, Revenue, Government finances, National economy

PROLOGUE

Tax is an important instrument in the hands of the Government to achieve economic and social objectives in India. For development and civilization of any nation, imposition of tax within the framework of logical tax structure is utmost necessary. In India too, attempts are being continuously made to formulate a simplified and rational tax structure though the effectiveness of such attempts is debatable. Direct taxation in its modern form has a long history in India. The most important direct tax was levied for the first time in 1860 in the form of a tax on income with the purpose of raising revenue for the Government. With the change in socio-economic and political situation, especially after independence, direct taxation has come to acquire an important place in the fiscal armory of the Government of India and is intended to achieve a variety of socio-economic objectives in

addition to serving as a source of revenue for the Government. After independence, structure of direct taxation in India has undergone fundamental changes especially in accordance with the recommendations of the Taxation Enquiry Commission (1953-54) and Kaldor's Report on Indian reforms (1956). New taxes were introduced for strengthening and having an integrated direct tax structure. However, even today income-tax is the most important of all the taxes in India. Various types of taxes levied by the Governments are divided into two broad categories: Direct and indirect taxes. Direct taxes are collected directly from the taxpayers through levies such as income-tax, agricultural income-tax, professional tax, etc., whereas indirect taxes comprise a medley of taxes, both at the central and state-level, like excise duty, sales tax, customs duty, value-added tax, octroi, entry

tax, service tax, expenditure tax, etc. However, with effect from 1st July, 2017, most of these taxes have been subsumed under a comprehensive and single indirect tax administered jointly by the Central and the State/UT Governments which is known as Goods and Services Tax (GST).

INTRODUCTION

Role of taxation in any scheme of financing economic development is well recognized. Economic development of any country depends to a large extent on the proper mobilization and efficient use of such resources by ensuring rational allocation between different sectors of the economy. In this context, taxation plays a crucial role in the sense that internal resources have to be mobilized and converted into more productive channels of the Indian economy by diverting them from the private and uneconomic avenues of expenditure as well as by establishing suitable transfer and comprehensive expenditure. Taxation is also an important instrument for reducing economic as well as regional inequalities. In this context, direct taxes play an important role. In the Indian perspective, direct taxation mainly brings economic equality. The impact and incidence of direct taxes is intended to be on those who pay to the Government. This paper highlights the direct tax structure and its implication on the assessee as well as on the common people in India.

OBJECTIVE OF THE STUDY

The objective of the paper is to analyze and interpret the importance of taxation, especially direct taxation in India.

RESEARCH METHODOLOGY

The study is conceptual and based on secondary data. Most of the data have collected from website, annual reports, books, journals, periodicals, various government orders, etc. As the study is conceptual in nature, the idea manifested in this paper is author's own opinion and also opinion of various reputed authors, lawyers, advocates, etc. For effective interpretation, the study has been divided into several sections as follows.

RESULTS AND DISCUSSION

Direct tax structure in India

Like many developed countries in the world, India has a well-developed and diversified tax structure with the authority to levy taxes divided between the Central Government and the State Governments. Direct taxes are mainly Central's subject except professional tax and

agricultural income-tax while indirect taxes can be levied both by the Central and the States. Direct tax in India is depicted in the following (Figure 1).

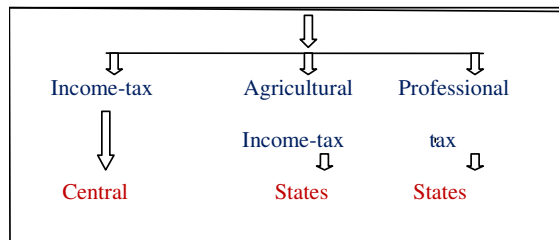


Figure 1. Direct tax structure in India. Note: Author's own elaboration.

Tax—its meaning and purpose

With the idea of welfare states, taxation is at present considered to be a mandatory payment levied on persons by the sovereign authority for bestowing common benefits upon the people of a country. It is distinguished from a fee in the sense that for payment of a fee one receives or expects to receive some specific benefit, while for payment of tax nothing is received directly in return. This implies that a person paying tax cannot demand any specific service in return for the tax paid by him. This, however, never means that a person paying tax receives nothing. The sovereign or the Government receiving tax spends the money for the common benefit or good of all the people rather than any specific person who pays it. Thus, to quote the late U.S. president, Franklin D. Roosevelt, "Taxes, after all, are the dues we pay for the privileges of membership in an organized society". In this context, the felicitous version of Justice Holmes is worth mentioning—"Taxes are what we pay for civilized society. I like to pay taxes. With them, I buy civilization". Every Government in every civilized country should look after the welfare of its citizens. For this, the Government requires resources. Tax is an important and significant source of Government's revenue for this purpose. With the help of this instrument, the Government can achieve various social and economic objectives.

Income-tax in India

In 1860, income-tax was introduced as an emergency measure particularly to solve the economic crises of 1857. Beginning with a source of revenue exclusively since 1860, it has maintained its sanctity, especially in the Indian tax management. Currently, income-tax is one of those Union taxes in which States have got increasing

stake. While immediately after independence, the net proceeds of taxes on income other than corporation tax are distributed among States and the Finance Commission has increased the share of states in this Union tax.

To make the distribution meaningful and commensurate with the requirements of the states, weight age to population for distribution of divisible pool of income-tax amongst States has also been increased. The present scheme of taxation of income operates through the Income Tax Act, 1961.

This Act is still in force in India. Each Finance Act and also Amendment Acts makes several changes to this Act. Moreover, the Central Board of Direct Taxes (CBDT) is also empowered to amend rules and to clarify instructions as and when it deems necessary. Most of the amendments and changes in the Act are brought into effect on the basis of the recommendations of the various reports. Tax is payable by natural as well as artificial persons on their net taxable income of the previous year. Thus, changes in the provisions of the Act are made frequently. The provisions of the Income-tax Act are like a railway ticket—goods only for one journey in times from 1st April to 31st March of the next and sometimes not even for the whole of that journey. With the plethora of provisions and their frequent changes, it has become very complicated to handle this Act effectively even by the experts, Simplification and rationalization of the Act is dire need today consequent to the globalization of our economy.

An understanding of the Income-tax Law requires a study of: (1) Income Tax Act, 1961; (2) Income Tax Rules, 1962; (3) Circulars, Classifications issued from time to time by CBDT; (4) Judicial decisions. Corporation Tax, first called Super Tax on Corporation or Companies was levied in India after the First World War (1914-1919). Under the Income-tax Act, corporation was supposed to pay this tax on the divisible profits on behalf of its stockholders who were given credit for the tax in their Budget, 1959-60, when the scheme of reform in company taxation was introduced. Revenue position from corporation tax being very strong has an important role in the direct tax revenue.

Current taxation policy offers special facilities to corporations through additional or initial depreciation, allowing rebate on undistributed profits, etc. Corporation tax has been often a subject of heavy criticism. Critics feel that corporation tax disheartens risky investment, distorts business judgment and deprives industries of the required funds. Nicholas Kaldor criticized it in his report on Indian Tax Reform: "The company taxation provisions of India (perhaps even more than that of other countries) are apt to strike a detached observer as a perfect intricate of unnecessary complication, the accretion of years of futile endeavor to reconcile fundamentally contradictory objectives". Kaldor suggested simplification in the whole system of company taxation.

Salient features of income-tax

The salient features of Income-tax are enumerated below:

- (i) Income-tax is an annual tax on income.
- (ii) Income-tax is computed with reference to a previous year as defined in Section 3.
- (iii) Income of the previous year is assessed in the following year known as assessment year in accordance with the provisions applicable for such assessment year,
- (iv) Tax is levied on every person.
- (v) While normal rates of tax are prescribed by the Finance Act, special rates of tax as specified by the Income-tax Act.

Stages in the imposition of income-tax

Lord Dunedin (*Whitney vs. Commissioner of Inland Revenue, 1926*) observed the following three stages in the imposition of tax:

Declaration of Liability: It is necessary to ascertain which persons are liable to pay tax and on which incomes as per provisions of the Act.

Assessment: It involves assessment of total income of a person and computation of tax thereon.

Recovery of Tax: The person liable to pay tax should pay the correct amount of tax voluntarily. But recovery proceedings have to be initiated or revised in case of failure as per provisions prescribed by the Act deliberately or involuntarily.

Income-tax is one tax

Section 14 of the Income-tax Act classifies all incomes of an assessee under five different heads, while Section 5 of the Act defines the range of such income in terms of the residential status of an assessee. Sections 15 to 59 of the Act lay down the detailed procedure regarding computation of such income under the respective heads. But Section 4 of the Act, the charging section and the backbone of the Income-tax Act imposes tax liability on every person in terms of 'total income' of the previous year. Thus, although there are five different heads of income, an assessee does not pay tax with reference to his income under one or more of these heads. An assessee pays tax on total income in accordance with the provisions of the Finance Act i.e. the aggregate of income of all the five heads less deductions admissible under Chapter VIA. The Income-tax law provides for a tax-payer to plan his taxes so that his tax liability is minimal. This is a well-cherished principle of tax law and is not surely bad for anybody to arrange his affairs so as to reduce tax burden to a minimum.

Administration of income-tax in India

Sound administration has an important role in achieving good performance in every aspect. Tax administration facilitates better understanding of the tax laws on the part of assesseees as this result in better tax compliance. Prior to 1953, Income-tax was the only personal tax in India. The extent to which resources can be mobilized through various taxes depends on the effective enforcement of the laws concerned. In India, attempts are being continuously made to formulate a simplified and rational tax structure though the effectiveness of such attempts is debatable. In order to do this, it is necessary that evasion, a common phenomenon associated with direct tax, be minimized. Evasion violates the canons of sound taxation. To check evasion, the tax machinery has to be more cautious. Every assessee is required to comply with certain obligations imposed by the Act e.g. filing of return of income within specified date, payment of advance tax within specified dates and installments, etc. Failure to comply with such obligations entails interest, penalties and prosecutions. The Department is also liable to pay interest to the assessee in certain cases. Any party aggrieved by the action of another party may prefer an appeal before the appropriate authority for lawful judgment. The party who prefers the appeal is known as 'appellant and the party against whom the appeal is preferred is known as 'respondent'. With respect to income-tax matters, appeal can be preferred either by the assessee or by the Commissioner of Income-tax or by both. The Commissioner of Income-tax can revise the order of the Assessing Officer as per section 263. The Commissioner can also revise the order u/s 264 on his own motion or an application made by the assessee. Any order passed by the Assessing Officer which has been the subject-matter of any appeal cannot be revised by the Commissioner. But in such case, the Commissioner may exercise his revisionary powers to such matters as had not been considered and decided in such appeal (CIT vs. Shri Arbunda Mills Ltd, 1998 and CIT vs. Jaykumar B. Patil (1999). Ample powers have been conferred on the tax authorities for survey, enquiry, investigation, scrutiny and calling for or seeking information for purposes of assessment in the Act. However, it is noticed that the information collected is not communicated and is not placed on the records and considered in assessments or for the purposes of the Act. However, very wide and varied powers have been given deserving exercise in accordance with law for the purposes of the Act and for use in the assessments.

Agricultural income-tax

Section 10(1) of the Income Tax Act, 1961 exempts agricultural income from income-tax. However, net agricultural income is added to the total non-agricultural

income computed as per Income Tax Act for the purpose of determining the income-tax on non-agricultural income of an assessee, if non-agricultural income exceeds the minimum taxable limit and the agricultural income exceeds Rs.5000. It is included with non-agricultural income for rate purposes. Due to this addition, tax liability on non-agricultural portion becomes high as the tax on the agricultural income will be deducted subsequently from the total tax liability on the integrated income.

Professional tax

Professional Tax has been enacted for the purpose of levy and collection of tax on professions, traders and employments. It extends to the whole of the State of West Bengal. The Act was brought into force with effect from 1.4.1979. This Act levies tax on every person who remains engaged in any profession, trade or employment. A person covered by more than one entry shall be liable to pay at the highest rate specified in any of the entries applicable to him. In case of salary and wage-earner, the primary liability for payment of tax is upon him. But the Act fixes such liability on the employer. The Act requires every employer to deduct the amount of tax that would be due and payable by such an employee at the time of making payment of salary or wage. The employer, after such deduction, is required to deposit the same. Failure to make deduction does not cease liability of the employer.

Tax planning vs Tax management

'Tax Planning' and 'Tax Management' are by-products of growing complexities of the tax laws and their numerous amendments. Judicious has also admitted that tax planning is a legitimate instrument of tax management. Tax planning and tax management imply taking maximum advantage available of the taxing statutes and reducing an assessee's tax liability within the framework of law. Such devices cannot be dubbed as tax avoidance manoeuvres. They are alternatively used for one and the same process. Increasingly complex contemporary societies with ever rising complexities of the laws have given birth to the modern management philosophy. Tax management basically comprises matters relating to legal formalities to avail of various tax incentives and to save the assesseees from the distress of consequences. Hence, tax management includes timely application for claiming incentives, timely payment of advance tax, self-assessed tax and timely preparation and submission of returns. The assesseees' planning of affairs not only helps them in a dignified manner but also succeeds in securing the objectives, tasks and goals set before them by the nation (McDowell and Co. Ltd. vs. CTO, 1985). As pointed out by Gerald Carson, tax avoidance is practiced

up and down the economic scale signified by misrepresentation, trickery, concealment and a patently lame and untenable excuse (Gerald Carson, 1977). The Gujarat High Court (CIT, Gujarat VS. Kartikay V. Sarabhi, 1981) has dwelt upon pillars popularly known as Golden Rules of tax management constituting golden rule both for the assessee and the revenue department in accomplishing an efficient illuminated tax system.

Conclusion

In Indian Direct tax structure, administrative aspect of direct taxes has often been neglected resulting into loss of revenue and cropping up of many problems. Administrative problems of income-tax are many. Notable among them are—tax evasion or under valuation of incomes and identifying new assessee. Other administrative problems are concerned with mounting arrears of assessments, collection and pendency of appeals, etc. Thus, it can be inferred that Indian tax structure needs a lot of changes to suit Indian conditions. Every individual is interested to save his tax. This is possible if a person takes full advantage of the various provisions contained in the Income-tax Act specially relating to deductions and exemptions. Tax laws provide different tax incentives for different categories of assessee and for different sources of income so that his tax liability is minimal. The Supreme Court in a case held that colorable (McDowell and Co. Ltd. vs. CTO, 1986) devices are certainly not part of the law and, therefore, cannot be part of tax planning. Arrangement for tax planning must be real and genuine and not a sham or make believe (Jiyajeerao Cotton Mills Ltd. vs. CIT/CEPT, 1985). However, all exemptions, deductions, allowances, etc. are not available to all categories of taxpayers. Many tax payers resort to illegal activities to save income-tax; but, such activities are not a part of tax planning process but a part of tax evasion which is always disparaging. However, one can go ahead with legal ways of saving income-tax and find out the pointers which are of advantage looking to the facts and circumstances.

Concluding comment

Albert Einstein once remarked, "The hardest thing in the world to understand is income-tax". The greatest scientist of our time had probably echoed on what Lord Cairns had observed as an expert of the subject: "Tax and equity are strangers and an equitable construction cannot be put upon the words of taxing statutes". Undoubtedly, the way of taxpayers is hard; legislature does not go out of its way to make it easier. The single piece of legislation touching the maximum number of citizens directly and the one undergoing discernible changes almost every year is the Income-tax Act. It is debatable whether fundamental

change in the basic approach towards taxing income has ever taken place in India despite appointment of committees and commissions and the official claim of the Government at the centre, at times, about their policies. But changes take place manifesting the desire of the Government at the centre to broaden the net, to respond to some popular demands about rebates and reliefs, to provide incentive for development, to plug loopholes giving scope for evasions and the like. The practitioners, the taxpayers and above all the learners of the subject have to face these changes in an already cumbersome Act.

Author's declaration

I declare that this study is my research work and I agree to publish it in the journal.

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