INTRODUCTION TO INDIAN TAX SYSTEM

(CBCS in Accordance with NEP 2020)

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Public revenue: tax and non-tax, Public expenditure and its categories, Budget: meaning, components, types, Fiscal policy: instruments and objectives, Fiscal federalism and tax sharing, GST compensation mechanism (conceptual overview)

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Unit 12: Taxpayer Services, Ethics and Responsibilities

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Concept of international taxation; Double Taxation: meaning & relevance; Double Taxation Avoidance Agreements (DTAA): purpose & overview; Role of OECD & BEPS initiative (concept only); Transfer pricing (purely conceptual); Global trends in taxation and their influence on India.

Unit 14: Contemporary Issues & Trends in Indian Taxation

Impact of GST reforms and changes; Faceless assessment & digital compliance; Taxation of digital economy; Environmental taxation (carbon tax, green initiatives); Informal sector and taxation challenges; Future directions of India’s tax system.

COURSE INTRODUCTION

This course on **Introduction to Indian Taxation**, designed under CBCS as per NEP 2020, offers a clear conceptual understanding of the Indian tax system, its objectives, principles, constitutional basis, and the structure of direct and indirect taxes with special reference to GST. It also introduces essential tax terminology, basic compliance procedures, and explains the link between taxation, public finance, economic development, digital transformation, taxpayer rights, and emerging trends in Indian taxation. **The course helps learners build a strong foundational understanding of taxation, enabling them to comprehend tax practices, policies, and their practical relevance in real-life economic and administrative contexts.**

Unit 1: Introduction to Taxation
This unit explains the meaning, nature, objectives, and characteristics of taxation along with the basic principles and canons of a good tax system. It also introduces the types of taxes and the role of taxation in modern economies. This helps learners build a strong conceptual base to understand why taxation exists and how it functions in society.

Unit 2: Historical Evolution of the Indian Taxation System
This unit traces the development of taxation in India from the pre-independence period to modern reforms influenced by major committees. Learners understand how and why the Indian tax system has evolved towards transparency and digitization.

Unit 3: Constitutional Framework of Taxation in India
This unit discusses the constitutional provisions that define taxing powers of the Union and States, relevant Articles, and the role of the Finance Commission. It helps learners understand the legal foundation of taxation in India.

Unit 4: Classification and Structure of Taxes in India
This unit explains the classification of taxes, tax incidence, and the structure of direct and indirect taxes with a conceptual overview of GST. Learners gain clarity on how different taxes are structured and applied.

Unit 5: Basic Tax Concepts and Terminology
This unit introduces essential tax terms such as assessee, assessment year, previous year, exemptions, deductions, and residential status. It helps learners become familiar with the basic language used in taxation.

Unit 6: Fundamental Principle of Taxation
This unit focuses on equity in taxation through the benefit principle and ability to pay principle, along with tax rate schedules. Learners understand the fairness and logic behind tax systems.

Unit 7: Taxation Procedure & Compliance Framework
This unit provides an overview of tax return filing, PAN, TAN, Aadhaar linkages, assessments,

advance tax, and tax audit concepts. It helps learners understand basic tax compliance procedures.

Unit 8: Indian Indirect Tax Framework – Overview
This unit explains the evolution of indirect taxes from sales tax to GST, its structure, types, place of supply, and input tax credit. Learners understand how GST functions and its impact on business decisions.

Unit 9: Economic Impact of Taxation
This unit discusses how taxation affects consumption, savings, investment, and economic development, along with concepts like tax buoyancy and black money. It helps learners link taxation with economic outcomes.

Unit 10: Public Finance and Taxation
This unit explains public revenue, public expenditure, budget, fiscal policy, and fiscal federalism. Learners understand how taxation supports government finance and policy implementation.

Unit 11: Digital Transformation in Taxation
This unit highlights digital initiatives such as e-filing, GSTN, AI-based systems, AIS/TIS, and e-invoicing. Learners become aware of modern technological changes in tax administration.

Unit 12: Taxpayer Services, Ethics and Responsibilities
This unit explains taxpayer rights, responsibilities, ethical issues, grievance redressal, and transparency in tax administration. It promotes awareness of ethical tax practices.

Unit 13: International Taxation – Basics
This unit introduces concepts of international taxation, double taxation, DTAA, OECD, BEPS, and transfer pricing. Learners gain basic awareness of global taxation practices influencing India.

Unit 14: Contemporary Issues & Trends in Indian Taxation
This unit discusses recent reforms such as faceless assessment, taxation of the digital economy, environmental taxation, and challenges in the informal sector. Learners understand the current trends and future direction of Indian taxation.

Each unit includes some alongside boxes to help you know some of the difficult, unseen terms. Some “EXERCISES” have been included to help you apply your own thoughts. You may find some boxes marked with: “LET US KNOW”. These boxes will provide you with some additional interesting and relevant information. Again, you will get “CHECK YOUR PROGRESS” questions. These have been designed to self-check your progress of study. It will be helpful for you if you solve the problems put in these boxes immediately after you go through the sections of the units and then match your answers with “ANSWERS TO CHECK YOUR PROGRESS” given at the end of each unit.

UNIT 1: INTRODUCTION TO TAXATION

UNIT STRUCTURE

1.1 Learning Objectives

1.2 Meaning & Nature of Taxation

1.3 Canons of Taxation

1.4 Shifting and Incidents of Tax

1.5 Direct & Indirect Taxes

1.5.1 Merits and demerits of Direct Taxes

1.5.2 Merits and demerits of Indirect Taxes

1.6 Role of taxation in modern economies

1.7 Let Us Sum Up

1.8 Further Readings

1.9 Answer to Check Your Progress

1.10 Model Questions

1.1 LEARNING OBJECTIVES

By the end of this unit, learners will be able to:

- Define the concept of taxation and also state its characteristics Discuss the canons of taxation distinguish between direct and indirect taxes
- Explain the concepts of shifting and incidence of taxation

1.2 MEANING & NATURE OF TAXATION

A tax is a compulsory contribution imposed by the public authorities on the people without any direct benefit rendered in return. Taxation has the following features: Compulsory contribution: A tax is a compulsory contribution in the sense that it is mandatory for the individual or entity on which it is imposed. Refusal to pay taxes is considered to be a cognigible offence and attracts legal action. No 'quid-pro quo': Payment of taxes does not ensure any direct benefits from the state in return to the tax payer. Resources mobilized through Taxes are disbursed as public expenditure to the general public, and any one tax payer can not claim any privileges in that disbursal. Fiscal instrument: Besides being a source of public revenue, Taxes are also used to achieve desirable objectives to and restrict the undesirable ones. Hence, it is one of the three fiscal instruments. For example, heavy taxation is imposed on alcohol and tobacco consumption. On the contrary, Tax on essential items are minimized to facilitate their consumption.

1.3 CANONS OF TAXATION

Canons of taxation indicate the attributes of a good tax system. Initially four canons of taxation were prescribed by Adam Smith. However, later writers have added a few more canons to the assigned list.

Canon of Equity: The canon of equity requires that the burden of tax should be equitably distributed. This is achieved by taxing every individual according to his ability to pay. Thus, equity demands that the richer sections of the society should bear a greater burden of the tax as compared to the poorer sections.

Canon of Certainty: The canon of certainly requires that the tax that one has to pay must be certain and non –arbitrary. This implies that the amount of tax, the time of payment and the manner payment must be clearly stated to the tax payers and also to every member of the public. The certainty principle prepares the taxpayer towards how much tax he has to pay and when. Besides, it enables the state to ascertain how much of tax revenue that it can hope to mobilize.

Canon of Convenience: The canon of convenience requires the time and the mode of payment of tax to be such that it causes minimum inconvenience to the tax payers. Thus, in the words of Adam Smith," every tax ought to be levied at the time or in the manner in which it is most likely to be convenient to pay it." Thus, for example ,agricultural tax should be collected during the harvest season ,as it is the most

convenient time to make payment for the agriculturists. Similarly, a convenient mode of tax payment for salaried persons is for tax to be deducted at source, when they receive their salaries.

Canon of Economy: The canon of economy requires that the cost of collection of Tax must be minimum. Thus a good tax system would need to incur the least expenditure on the collection of taxes. According to Adam Smith," every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state". Thus, tax requiring excessive collecting cost should be avoided.

Since the days Adam Smith, a few more canons have come to be widely accepted in the discipline of public finance. They are

Canon of Productivity: With revenue mobilisation as one of the primary objectives of taxation, the canon of productivity requires the tax that is imposed to be productive. It adheres to the principle that it is better to have a few taxes that are productive rather than to have a large number of taxes whose yields are low.

Canon of Simplicity: The structure of the taxation system and the laws that govern it should be simple so that it is easily understood by the common people. This enables people to make their necessary tax payments without any difficulties and prevents them from becoming involuntary tax-evaders.

Canon of Elasticity: This canon requires the taxation system to be elastic or flexible in nature. Accordingly, tax revenue mobilised should rise and fall in line with the respective upswing and downswing of the economy.

Canon of Diversity: This canon requires the tax system to be diversified with a large number and variety of taxes. On the one hand, this allows the state to bring all sections of the population within the tax net, whereas on the other hand, it provides the state with alternative sources of revenue if one tax fails to mobilise the expected revenues.

CHECK YOUR PROGRESS

Q 1: State whether the following statements are True (T) or False (F)

(a) Tax is a compulsory payment made under a 'quid-pro-quo' arrangement. (True/False)

(b) Taxation constitutes one of the three basic fiscal instruments. (True/False)

(c) Canon of equity requires that the tax that one has to pay must be certain and non-arbitrary. (True/False)

Q.2: Mention the four initial canons of taxation as propounded by Adam Smith. (Answer in about 30 words)

1.4 SHIFTING & INCIDENTS OF TAX

The incidence of tax is upon that individual who bears the direct money burden of the tax. However, the incidence of tax may not necessarily rest on the individual who bears the initial money burden (i.e the import of the tax). This happens when the individual on whom the imposed tax falls, succeeds in shifting the burden to another individual. Thus, here the impact of the tax is on the first individual whereas the incidence is on the second individual to whom the tax had been shifted. Shifting is usually undertaken by raising the price of a commodity sold by an amount equal to the tax. Hence, the impact refers to the initial money burden of the tax. The process of transferring the direct money burden of tax to another individual is called the shifting of the tax. Finally, the incidence of tax is on the person who ultimately bears the burden. Thus, it is the final resting place of the direct money burden of tax

1.5 DIRECT & INDIRECT TAXES

Taxes can be classified into direct taxes and indirect taxes. A direct Tax cannot be shifted. Thus, in the case of direct tax, the impact of the tax as well as its incidence is on the same person. Income tax is a typical example of a direct tax, as its impact as well as its incidence falls on the same individual. This happens because shifting of income tax is not possible. On the other hand, an indirect tax is a tax that can be shifted. Thus, in the case of an indirect tax, the impact of the tax falls on the person, who successfully shifts it to another person. Subsequently, the incidence of the tax falls on the second person. A typical example of an indirect tax is sales tax. Here, the initial burden of (i.e the impact) of the tax falls on the dealers of a commodity that is being sold. However, the dealer shifts the tax to the buyer by adding the amount of tax to the price of the commodity. In this case, although the impact is on the dealer, however the incidence is shifted to the buyers

Common direct taxes include income tax, wealth tax, gift tax, property tax, estate duty etc. On the other hand, common indirect taxes would include sales tax, excise duties, export duty, import duty, entertainment tax etc.

1.5.1 Merits and demerits of Direct Taxes

Merits: Direct taxes have the following merits:

Equitable: Direct taxes are equitable because their burden falls more heavily on richer section of the society. This happens because direct taxes are based on the principle of" Ability to Pay "where richer people make bigger tax contribution, while the poorer people are asked to make a relatively smaller contribution. In fact, people below a particular level of income and wealth are exempted from paying income taxes.

Distributive justice: Direct taxes are usually progressive in nature. This implies that their burden falls more heavily on the richer sections of the society than that of the relatively poor. As most of the public expenditure financed by tax resources targets the poor, direct taxes induces income redistribution in favour of the relatively poor sections of the society.

Certainty: Direct taxes satisfy the canon of certainty as it enables the state to estimate the resources that it can generate in the coming period. Similarly, the tax payers are also in a position to know how much tax they have to pay and in what point of time in the future.

Elasticity : Direct taxes are elastic as their yields can be easily increased or decreased by increasing or decreasing either the tax rates or the tax coverage Besides, they are buoyant because the yields from direct taxes expand as the economy enjoys upswings and contracts as it suffers from downswings.

Economy and convenience : Direct taxes are economical in collection and administration. As they are progressive in nature, an increase in revenue through direct taxes can be brought about without a corresponding increase in the cost of collection. They are convenient to collect as they are deducted at source in the case of salaried income earners. Besides, non salaried tax payers can pay the tax at a particular time period which enhances collection efficiency.

Demerits : Despite their merits, direct taxes suffer from some serious limitations.

Not popular : Direct taxes are unpopular because they have to be paid by the taxpayer in lump sums at one go. This imposes great burden on the tax payer who earns his income in smaller amounts throughout the year. Besides, the requirement of submission of detailed account of income, wealth etc and the filing of tax returns impose additional burden of tax which is highly resented.

Tax **Evasion :** Direct taxes are usually progressive in nature. This induces many tax payers to evade tax by understating their income and wealth. As only the honest people end up bearing

the full burden of direct taxes, hence sometimes it is said that “direct taxes are a premium on honesty”.

Arbitrary : Direct Taxes are usually progressive and is based on the principle of ‘ability to pay’. However, in the absence of an objective measure of ‘ability to pay’, tax rates are fixed arbitrarily. Here, there is a strong possibility of underestimation or overestimation of the taxable capacity of the people.

Inadequate in a poor country : In poor and underdeveloped countries, the vast majority of the population is poor and lies within the exemption limit of direct taxes. Given the small number of eligible tax payers, proceeds from direct tax prove to be inadequate to meet the revenue requirement of the public authorities.

1.5.2 Merits and demerits of Indirect Taxes

Merits: Indirect taxes exhibit the following merits:

Greater Coverage : Unlike direct taxes, indirect taxes ensure greater coverage of the population. This is very significant in poor countries where large segments of the population remain untouched by direct taxes. In fact, in many such countries revenue mobilized from indirect taxes largely exceeds what is mobilised by direct taxes.

Convenient and less unpopular : Indirect Taxes are hidden in the price of goods and services and are payable only in small amounts. As the burden is spread over an extended period of time, people find it convenient and hence it is less unpopular as a tax.

Less tax evasion: As indirect taxes are included in the price of goods and services, they are difficult to evade. The only way to avoid indirect taxes is to stop consumption. However, indirect taxes are evaded by smuggling which can be controlled by more effective policing.

Promotion of social welfare: Indirect taxes can be heavily imposed on harmful commodities like alcohol, tobacco etc. to curb their consumption. Conversely, merit goods like milk, medicine etc can be lightly taxed to promote their use.

Demerits: Indirect taxes suffer from the following demerits.

Regressive and Inequitable : Indirect taxes have to be paid equally by all sections of the society, without any distinction being made between the rich and the poor. Given their relatively lower income, the real burden of such taxes are much more on the poor than on the rich. Hence, indirect taxes are considered to be regressive and inequitable.

Uncertainty in mobilization: As resources mobilized through indirect taxes depend on consumption expenditure, the precise amount of resources that can be mobilized is difficult to estimate. Besides, the demand for same goods falls when their tax induces the prices to go up. For such goods, it is difficult to estimate the tax that can be collected through indirect taxation.

High collection cost: Indirect taxation includes a very high collection cost as large tax machinery needs to be maintained to ensure tax compliance and to minimize tax evasion. Hence, in many instances, the 'canon of economy' is not found in the case of indirect taxation.

Inflation: A major demerit of indirect taxation is that it generates inflation in the economy. Hence, as taxes increase the price of the commodities, inflation in the economy ensues. In fact, higher prices for taxed commodities induce a rise in the factor prices which in turn raises the production cost leading to further increases in commodity prices. Hence, indirect taxes result in a cumulative upward spiral in the commodity prices and induce cost-push inflation

CHECK YOUR PROGRESS

Q3: State whether the following statements are True (T) or False (F) :

(a) Incidence is the final resting place of the direct money burden of a tax. (True/False)

(b) A direct tax can be shifted by one individual to the other. (True/False) (c) A merit of indirect tax is that it enables greater coverage of the population. (True/False)

Q4: How does indirect tax result in less tax evasion? (Answer in about 40 words)
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1.6ROLE OF TAXATION IN MODERN ECONOMICS

Taxation occupies a central place in modern economic systems. It is not merely a means of raising revenue for the government, but a powerful instrument for achieving various socio-economic objectives. In contemporary economies, taxation influences production, consumption, distribution of income, and overall economic stability. Thus, taxation plays a multidimensional role in shaping the economic structure of a nation.

1. Source of Government Revenue

The primary role of taxation is to generate revenue for the government. This revenue is used to finance public goods and services such as defence, education, healthcare, infrastructure, law and order, and social welfare schemes. Without adequate tax revenue, the government cannot perform its essential functions.

2. Redistribution of Income and Wealth

Modern taxation follows the principle of equity. Through progressive taxation, higher income groups are taxed at higher rates, which helps reduce income inequality. The revenue collected is often used for welfare programmes that benefit the poorer sections of society, thereby promoting social justice.

3. Economic Stability

Taxation acts as an automatic stabilizer in the economy. During inflation, higher taxes reduce disposable income and curb excessive demand. During deflation or recession, tax reductions increase purchasing power and stimulate demand. Thus, taxation helps in maintaining economic stability.

4. Promotion of Economic Growth

Tax policies can encourage savings, investment, and capital formation. Tax incentives, exemptions, and rebates provided to industries and entrepreneurs promote industrial growth, employment generation, and overall economic development.

5. Regulation of Consumption

Taxes are imposed on harmful goods such as tobacco, alcohol, and luxury items to discourage their consumption. This helps in protecting public health and maintaining social welfare.

6. Encouragement of Priority Sectors

The government uses taxation to promote priority sectors like agriculture, small-scale industries,

renewable energy, and exports by providing tax concessions and subsidies. This ensures balanced regional and sectoral development.

7. Control of Inflation

By increasing tax rates, the government can reduce excess purchasing power in the hands of people, thereby controlling inflationary pressures in the economy.

8. Mobilization of Resources

Taxation helps in mobilizing domestic resources for national development. It reduces dependence on foreign aid and borrowings and strengthens the financial autonomy of the country.

9. Reduction of Black Money

A well-structured tax system with strict compliance measures helps in reducing tax evasion and the generation of black money, thereby promoting transparency in the economy.

10. Instrument of Fiscal Policy

Taxation is a major component of fiscal policy. Along with public expenditure, it helps the government regulate economic activities and achieve macroeconomic objectives.

1.7LET US SUM UP

In this unit, we discussed the fundamental concepts of taxation and its importance in the economic system. Taxation is a compulsory contribution imposed by the government without any direct quid-pro-quo, and it serves as a major fiscal instrument for mobilizing public revenue and achieving socio-economic objectives.

The unit explained the **meaning and nature of taxation**, highlighting its essential features such as compulsion, absence of direct benefit, and its role as a fiscal tool. We then examined the **canons of taxation** as propounded by Adam Smith—equity, certainty, convenience, and economy—along with additional modern canons like productivity, simplicity, elasticity, and diversity, which together form the basis of a sound tax system.

Further, the concepts of **shifting, impact, and incidence of tax** were discussed to understand who ultimately bears the burden of taxation. The classification of taxes into **direct and indirect taxes** was also explained, along with their respective merits and demerits.

Finally, the unit highlighted the **role of taxation in modern economies**, emphasizing that taxation is not only a source of revenue but also an instrument for redistribution of income, economic stability, growth, control of inflation, regulation of consumption, and promotion of social welfare.

Thus, this unit provides a comprehensive understanding of taxation, its principles, types, and its vital role in the functioning of a modern economy.

1.8 FURTHER READINGS

Bhatia, H. L. (2006). Public Finance. New Delhi : Vikas Publishing House Pvt.

Lekhi, R. K. (2006). Public Finance and Fiscal Policy. Ludhiana : Kalyani Publishers.

Menkar and Sarma. (2001). Public Finance : Theory and Practice. Mumbai : Himalaya Publishing House.

Prakash, O. (2008). Public Economics : Theory and Practice. Jalandhar : Vishal Publishing Co

1.9 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: (a) False (b) True (c) False

Ans to Q No 2: The initial four canons of taxation as prescribed by Adam Smith are:

• canon of equity, • canon of certainty, • canon of convenience, and (c) True • canon of economy.

Ans to Q No 3: (a) True (b) False

Ans to Q No 4: Indirect taxes are included in the price of goods and services, and therefore, they are difficult to evade. The only way to avoid indirect taxes is to stop consumption. However, indirect taxes are evaded by smuggling which can be controlled by more effective policing.

1.10 MODELS QUESTIONS

A. Short Questions (Answer each question in about 150 words)

Q 1: Explain the concepts of impact, shifting and incidence of tax.

Q 2: Distinguish between direct and indirect taxes.

Q 3: Discuss the meaning and features of taxation. B.

Long Questions (Answer each question in about 300-500 words) Q 1: State and explain the canons of taxation.

Q 2: Compare the merits and demerits of direct taxes with those of indirect taxes.

UNIT 2: HISTORICAL EVOLUTION OF INDIAN TAX SYSTEM

UNIT STRUCTURE

2.1 Learning Objectives
2.2 Introduction
2.3 History of taxation

2.3. 1 Types of Taxes

2.3.2 Timeline of Tax Development in India

2.4 Need for tax reforms

2.5 Major Committees on Tax Reforms in India-

2.5.1 Committee of Raja Chelliah (1991)

2.5.2 Rekhi Committee on Indirect Tax Reforms (1992)

2.5.3 Kelkar Committee Report on Tax Reforms-

2.5.4 GOODS AND SERVICES TAX (GST)

2.6India’s shift towards digital and transparent tax administration

2.7Let us sum up

2.8Answers to check your progress

2.9 Future reading

2.10Model questions

2.1 LEARNING OBJECTIVES

After studying this unit, students will be able to:

- Understand the historical development of taxation in India.
- Explain pre-independence revenue systems and tax reforms.
- Identify the role of Raja Chelliah and Kelkar Committees in tax reforms.
- Understand the NEED FOR TAX REFORMSs in India.
- Explain India's shift towards digital and transparent tax administration.

2.2 INTRODUCTION

Taxation plays a crucial role in the economic and administrative functioning of any country. It is one of the primary sources of revenue for the government, enabling it to provide essential public services such as infrastructure development, education, healthcare, defence, social welfare, and governance. A well-designed tax system not only helps in mobilizing financial resources but also promotes economic growth, income equality, and overall national development.

India has a long and rich history of taxation, dating back to ancient times. From the principles laid down in texts such as Manusmriti and Arthashastra to the structured tax laws introduced during British rule, the Indian tax system has continuously evolved with changing economic and political conditions. After independence, India adopted a modern taxation framework through the Income Tax Act, 1961, which laid the foundation of the present direct tax system.

Over time, the growing complexity of the economy, globalization, expansion of the service sector, and technological advancement created the need for major tax reforms. Various expert committees were formed to review shortcomings in the existing system and recommend reforms aimed at simplifying tax laws, widening the tax base, improving compliance, and increasing

government revenue. These reforms ultimately led to landmark changes such as the introduction of Value Added Tax (VAT) and the Goods and Services Tax (GST).

In recent years, India has also taken significant steps towards digitalization and transparency in tax administration. Initiatives such as e-filing, faceless assessments, GST Network (GSTN), and the use of data analytics and artificial intelligence have transformed the tax system into a more efficient, transparent, and taxpayer-friendly framework.

This chapter provides a comprehensive understanding of the history of taxation in India, types of taxes, evolution of tax laws, need for tax reforms, contributions of various reform committees, introduction of GST, and India's transition towards a digital and transparent tax administration system. Together, these developments highlight how taxation has emerged as a vital instrument for economic stability, growth, and good governance in India.

2.3 HISTORY OF TAXATION IN INDIA

"The word 'tax' comes from the Latin word 'taxare'", which means to assess the value of something. A tax is an amount collected by the government from people and businesses to run the country. Taxes are used by the government to provide public services like roads, schools, hospitals, defence, and administration. Therefore, taxes are an important source of government revenue.

A country's economy becomes strong when it has a fair and efficient tax system. A good tax system helps in economic growth, increases GDP, and improves the standard of living of people. It also helps in proper distribution of income and economic stability.

2.3. 1 Types of Taxes

There are two main types of taxes:

1. Direct Tax-

   These taxes are paid directly to the government by individuals or organisations. Examples:

   - Income Tax
   - Property Tax

2. Indirect Taxes

   These taxes are paid through another person or seller while purchasing goods or services.

   Examples:

   - Service Tax
   - GST

2.3.2 Timeline of Tax Development in India

(a) Ancient Period: Manusmriti and Arthashastra

In ancient India, taxation was considered an important duty of the king. Manusmriti states that taxes should be collected fairly and without causing hardship to the people. Traders and artisans were required to pay about one-fifth of their income, while farmers paid a part of their crop depending on the situation.

The Arthashastra (3rd century BCE) explains the economic and administrative system of the state. It followed the principle that rich people should pay more tax than the poor. Farmers paid one-sixth of their produce, and taxes were also collected on trade, imports, exports, and tolls. Extra taxes were allowed during emergencies.

(b) British Period: Income Tax Acts (1860–1922)

The modern income tax system in India started during British rule. Income Tax was first introduced in 1860 by Sir James Wilson to meet the financial needs of the British government after the revolt of 1857. Income was divided into different heads such as land, salary, business, and securities.

Later, new Income Tax Acts were passed in 1886 and 1918 to improve tax collection and calculation of income. The Income Tax Act of 1922 was a major reform as it created a

proper tax administration system and remained in force until 1961. These Acts laid the foundation of India's present tax system.

(c) Transition to Modern Tax System: Income Tax Act, 1961

After independence, India introduced the Income Tax Act, 1961, which came into effect from 1 April 1962. This Act applies to the whole of India and forms the base of the current income tax system.

Under this Act, income is classified into five heads such as salary, business, capital gains, house property, and other sources. The Act also led to the formation of the Central Board of Direct Taxes (CBDT). It continues to guide tax calculation, tax payment, and administration in India.

2.4 NEED FOR TAXATION

The restructuring of India's tax system was an important part of fiscal reforms. The main aim was to increase government revenue and remove problems and complexities in the existing tax system.

1. **Complexity & Compliance:** Overlapping and complex tax laws (both direct & indirect) hinder voluntary compliance, leading to evasion and litigation.
2. **Economic Growth & Competitiveness:** Transition to a market economy requires competitive rates and simplified systems to attract investment and boost GDP.
3. **Low Tax-to-GDP Ratio:** Limited fiscal capacity due to low tax base restricts government spending on development.
4. **Administrative Efficiency:** Reducing bureaucratic delays in assessments and dispute resolution improves revenue flow and business ease.
5. **Modernization:** Need to incorporate new economic realities like digital assets (crypto) and align laws with evolving business models.
6. **Middle-Class Relief:** Addressing inflationary pressures and improving disposable income for salaried individuals.

The reforms focused on simplifying and rationalising both direct and indirect taxes.

2.5 MAJOR COMMITTEES ON TAX REFORMS IN INDIA

Several committees were formed in India to review the tax system and suggest reforms. These committees examined problems in taxation and recommended changes to improve efficiency, fairness, and revenue collection.

The first major committee was the Tax Reforms Committee (TRC) chaired by Raja J. Chelliah, which reviewed both direct and indirect taxes.Later, the Rekhi Committee focused mainly on indirect tax reform.Another important committee on tax reforms was chaired by Vijay Kelkar, which also examined both direct and indirect taxes.

2.5.1 Committee of Raja Chelliah (1991)

The Tax Reforms Committee was set up in 1991 and submitted its report in 1992. It suggested wide-ranging reforms in both direct and indirect taxes.

Recommendations on Direct Taxes-

- Personal income tax rates should be reduced, and the gap between the lowest and highest tax rates should be narrowed.
- Agricultural income should be brought under the tax system.
- Corporate tax rates should be lowered, and the difference between domestic and foreign company tax rates should not be more than 10 percent.
- Wealth tax should not apply to productive assets; only unproductive and socially undesirable assets should be taxed.
- Indexation should be allowed while calculating long-term capital gains to adjust for inflation.

Recommendations on Indirect Taxes

- The structure of customs duty should be simplified by reducing tariff rates and removing unnecessary exemptions.
- Excise duty laws and procedures should be simplified, and ad valorem duties should be preferred over specific duties.

- The excise duty system should gradually be converted into a Value Added Tax (VAT) system at the manufacturing stage.
- The services sector should be included under the tax net.

2.5.2 Rekhi Committee on Indirect Tax Reforms (1992)

The Rekhi Committee was constituted in 1992 under the chairmanship of K. L. Rekhi. Its major recommendations were related to improving tax administration and reducing disputes.

- A special tribunal should be established to settle disputes between taxpayers and tax authorities.
- An All-India Classification Committee with representatives from trade and industry should be formed.
- Imported goods should be cleared within three days to reduce delays.
- The monopoly of a single bank for tax collection in each state should be ended by allowing additional banks.
- Forceful recovery of disputed tax amounts should be avoided when the taxpayer has applied for a stay.

2.5.3 Kelkar Committee Report on Tax Reforms

A Task Force on Direct and Indirect Taxes was set up in 2002 under the chairmanship of VijayKelkar.The committee aimed to simplify the tax system, improve compliance, and widen the tax base.

Recommendations of the Kelkar Committee-

Direct Taxes

- The income tax exemption limit should be increased to ₹1 lakh, and for senior citizens and widows to ₹1.5 lakhs.
- A two-slab income tax structure was recommended:
    1. 20% on income between ₹1 lakh and ₹4 lakhs
    2. 30% on income above ₹4 lakhs.

- Standard deduction should be abolished, but conveyance allowance should be exempted.
- Long-term capital gains tax, dividend tax, and wealth tax should be abolished, and no surcharge should be levied on income tax.
- Most tax incentives for savings should be removed, except those meant for the handicapped.
- A 2% interest subsidy should be provided on housing loans up to ₹5 lakhs.
- Corporate tax rates should be:
    1. 30% for domestic companies
    2. 35% for foreign companies The committee also suggested abolishing Minimum Alternate Tax (MAT).
- Short-term capital gains from mutual funds should be taxed at 20%.
- There should be no distinction between unabsorbed depreciation and business losses.

Indirect Taxes

- A uniform 14% Central Value Added Tax (CENVAT) should be introduced.
- A nationwide VAT system and a comprehensive service tax should be implemented.
- Essential items such as life-saving drugs, security equipment, and agricultural products should be exempted from tax.
- Small-scale units with turnover up to ₹50 lakhs should be exempt from indirect taxes.

2.5.4Goods and Services Tax (GST)

The introduction of the Goods and Services Tax (GST) on 1 July 2017 is regarded as the most comprehensive reform in India's indirect tax system. Though not the outcome of a single committee, GST reflects decades of recommendations by expert bodies such as the Raja Chelliah and Kelkar Committees, which emphasized simplification of taxes, removal of cascading effects, and modernization of tax administration.

Before GST, multiple indirect taxes like excise duty, service tax, VAT, entry tax, and others were levied by the Centre and States, creating complexity and "tax on tax." GST replaced most of

these levies (except customs duty) with a unified system, reducing duplication and promoting uniformity.

GST is a destination-based tax operating under a dual model—CGST and SGST for intra-state trade, and IGST for inter-state trade—thereby maintaining the fiscal role of both the Union and the States while creating a common national market.

The GST Council, formed under Article 279A and chaired by the Union Finance Minister, recommends rates and procedures, reflecting cooperative federalism. Supported by the GST Network (GSTN), the system relies on digital processes for registration, returns, and payments, ensuring transparency and better compliance.

Thus, GST stands as the practical outcome of long-standing tax reform ideas and a major milestone in India's move toward a simpler and more efficient tax structure.

2.6 INDIA'S SHIFT TOWARDS DIGITAL AND TRANSPARENT TAX ADMINISTRATION

India has been moving towards a digital and transparent tax system to make tax administration more efficient, fair, and taxpayer-friendly. The government has introduced large-scale digitization such as e-filing, GST Network (GSTN), faceless assessments, and the use of advanced technologies like AI and data analytics. These reforms aim to reduce corruption, improve

compliance, and attract investors, though challenges like digital literacy and cybersecurity still remain.

2.6.1 Key Pillars of the Digital and Transparent Shift

1. **Faceless Ecosystem**

The faceless system uses technology for assessments, appeals, and scrutiny without direct interaction between taxpayer and tax officers. This reduces delays, discretion, and bias, and ensures fair and objective tax administration.

2. **GST Network (GSTN)**

GSTN is a single digital platform for registration, return filing, and tax payment under GST. It has replaced multiple indirect taxes and made tax compliance simpler and more transparent for businesses.

3. **E-filing and E-verification**

Income tax returns can be filed and verified online, without physical documents. This saves time, reduces paperwork, and allows faster processing and refunds.

4**. Data Analytics and AI / ML**

Advanced tools like data analytics and artificial intelligence are used to track tax compliance and detect evasion Projects such as Project Insight help the tax department make data-based and informed decisions.

5. **Tax Information Network (TIN)**

TIN is a system that manages and stores taxpayer-related data.
It helps in smooth information flow between taxpayers, banks, and tax authorities.

2.6.2 Benefits of Digital Tax Administration

1. Increased Efficiency and Speed

Digital systems reduce manual work, leading to faster assessments, quicker refunds, and less paperwork.

2. Greater Transparency and Trust

Reduced human involvement lowers corruption and increases fairness and taxpayer confidence.

3. Ease of Doing Business

Simplified procedures and online services make tax compliance easy for individuals and businesses.

4. Better Revenue Collection

Improved data tracking helps in detecting tax evasion and increases government revenue.

India's shift towards digital and transparent tax administration has modernized the tax system and improved efficiency, transparency, and compliance. Despite challenges like digital awareness and cybersecurity risks, these reforms have made the tax system more taxpayer-friendly and investor-attractive.

2.7 LET US SUM UP

- Taxation in India has evolved from ancient principles of fairness in Manusmriti and Arthashastra to a modern, technology-driven system.
- The British period laid the foundation of income tax administration, which was later strengthened by the Income Tax Act, 1961 after independence.
- Growing economic complexity, low tax base, and administrative inefficiencies created a strong need for tax reforms.
- Major reform committees are Raja J. Chelliah, Rekhi, and Vijay Kelkar played a crucial role in simplifying tax laws, rationalizing rates, expanding the tax base, and improving compliance.
- These reforms gradually transformed India's fragmented indirect tax system into a unified structure, culminating in the introduction of GST in 2017, a landmark reform promoting "One Nation, One Tax."
- India's shift toward digital and transparent tax administration through e-filing, GSTN, faceless assessments, and AI-based monitoring has improved efficiency, accountability, and taxpayer confidence.
- Although challenges such as digital literacy and cybersecurity remain, the reforms have made the tax
- System more fair, growth-oriented, and investor-friendly.
- Overall, India's taxation system today reflects a transition from traditional revenue collection to a modern, transparent, and technology-enabled framework that supports economic development and good governance.

CHECK YOUR PROGRESS

1. What is meant by digital tax administration?
2. Who chaired the Raja Chelliah Committee?
3. In which year was the Kelkar Committee constituted?

4. What was the main focus of the Rekhi Committee?
5. Write any two objectives of digital tax reforms in India.
6. What is GST Network (GSTN)?
7. What is e-filing of income tax returns?

ANSWERS TO CHECK YOUR PROGRESS

Answer to Q1- Digital tax administration refers to the use of technology such as online filing, data analytics, and electronic systems to manage tax collection, assessment, and compliance efficiently and transparently.

Answer to Q2-The Raja Chelliah Committee was chaired by Raja J. Chelliah**.**

Answer to Q3-The Kelkar Committee was constituted in 2002.

Answer to Q4-The main focus of the Rekhi Committee was improving indirect tax administration and reducing tax disputes**.**

Answer to Q5-a) To improve transparency in tax administration.

b)To simplify tax compliance and reduce corruption.

Answer to Q6-GST Network (GSTN) is an online digital platform that manages GST registration, return filing, and tax payments in India.

Answer to Q7-E-filing is the process of submitting income tax returns electronically through the official income tax website.

2.9 FURTHER READING

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2.10MODEL QUESTIONS

1. Explain India’s shift towards digital and transparent tax administration.
2. Discuss the key pillars of digital tax reforms in India.
3. Discuss in detail the recommendations of the Raja Chelliah Committee on tax reforms.
4. Examine the role of the Kelkar Committee in reforming India’s tax system.
5. Compare the recommendations of Raja Chelliah Committee and Kelkar Committee.

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UNIT 3: CONSTITUTIONAL FRAMEWORK OF TAXATION IN INDIA

UNIT STRUCTURE

3.1 Learning Objectives
3.2 Introduction
3.3 Taxing Powers Under The Constitution
3.3.1 Union Tax Powers
3.3.2 State Tax Powers
3.3.3 Residuary And Local Tax Powers
3.4 Articles Related To Finance And Taxation
3.4.1 General Principles And Authority To Tax
3.4.2 Distribution Of Tax Revenues
3.4.3 Protection For Certain Union And State Interests
3.5 Finance Commission And Its Role
3.6 Constitutional Amendments Related To Taxation
3.6.1 Evolution Before GST
3.6.2 The 101st Constitutional Amendment And GST
3.7Let Us Sum Up
3.8Further Readings
3.9Answers To Check Your Progress
3.10Model Questions

3.1 LEARNING OBJECTIVES

After studying this unit, the learner will be able to:

- Explain how taxing powers are divided between the Union and the States in the Constitution of India.
- Identify the key constitutional articles that deal with taxation and finance.
- Describe the constitutional status, functions and importance of the Finance Commission of India.

- Outline the major constitutional amendments that have changed the tax system, especially the Goods and Services Tax.
- Discuss how the constitutional framework supports fiscal federalism and cooperative relations between Union and States in taxation matters.

3.2 INTRODUCTION

Taxation is the main way by which governments raise money to provide public services such as defence, infrastructure, health and education. In India, the power to levy and collect taxes does not rest on ordinary laws alone. It is rooted in the Constitution of India, which is the supreme law of the land. The Constitution lays down clear rules about which level of government can tax which base, how tax revenues are shared, and what checks exist to protect citizens and different levels of government.

India has a federal structure where powers are divided between the Union and the States. This division also applies to taxation. The Union has wider powers to tax because it has to meet large national responsibilities, while States have more limited but still important tax powers that help them fund state level functions. To manage this system, the Constitution also provides for a Finance Commission that works as a balancing body between Union and States for sharing tax revenues. Over time, constitutional amendments have updated the framework to respond to new needs, such as the introduction of the Goods and Services Tax.

3.3 TAXING POWERS UNDER THE CONSTITUTION

The main provisions on distribution of legislative powers, including taxation, are found in Article 246 and the Seventh Schedule of the Constitution. The Seventh Schedule contains three lists. The Union List (List I) gives subjects on which only Parliament can make laws. The State List (List II) gives subjects on which only State Legislatures can make laws. The Concurrent List (List III) covers subjects on which both Parliament and State Legislatures can legislate, but this list does not contain taxation entries.

For taxation, the Constitution follows a principle of separation. Specific taxes are assigned either to the Union List or to the State List, and there are no concurrent tax entries. This means that for a particular tax base only one level of government can levy that tax directly.

1. The Fundamental Rule of Taxation

Before understanding *who* can tax, it is important to understand the basic rule set by the Constitution.

Constitutional Article	Meaning	Explanation
Article 265	**No Tax Without Law**	The government cannot collect any tax from citizens unless there is a specific law passed by the Parliament or State Legislature authorizing it. An executive order (a simple government instruction) is not enough; a proper statute or Act is required.

2. Who Taxes What? (The Three Lists)

Article 246 of the Constitution divides the power to make laws (including tax laws) into three lists found in the **7th Schedule**. This avoids conflict between the Central (Union) Government and State Governments.

A. Union List (List I) - Taxes collected by Central Government

Only the Parliament (Central Govt) can make laws and taxes on these items.

Entry No.	Tax Subject	Explanation
Entry 82	**Income Tax**	Tax on earnings of individuals and companies, **except** income from farming (agriculture).
Entry 83	**Customs Duty**	Tax on goods being imported into India or exported out of India.
Entry 84	**Excise Duty**	Tax on goods manufactured in India. Currently, this mainly applies to petroleum products (petrol, diesel, crude oil) and tobacco.
Entry 85	**Corporation Tax**	Tax on the income/profits of companies.
Entry	**Capital Value**	Taxes on the capital value of assets (excluding farm land) of

86	**Tax**	individuals and companies.
Entry 88	**Succession Duty**	Duties regarding inheritance of property (other than farm land).
Entry 92A	**Inter-State Trade Tax**	Taxes on buying or selling goods (other than newspapers) where the trade happens between two different states.
Entry 97	**Residuary Powers**	If a new type of tax arises that is not mentioned in any list (State or Concurrent), the Central Government gets the power to tax it.

B. State List (List II) - Taxes collected by State Governments

Only the State Legislatures can make laws and taxes on these items.

Entry No.	Tax Subject	Explanation
Entry 46	**Agricultural Income Tax**	Only States can tax income earned from farming/agriculture.
Entry 51	**Excise on Alcohol**	Taxes on alcoholic liquor for human consumption and narcotics (opium, etc.) manufactured within the state.
Entry 53	**Electricity Tax**	Taxes on the consumption or sale of electricity.
Entry 54	**Sales Tax / VAT**	Taxes on the sale of petroleum products and alcohol (items not covered by GST) inside the state.
Entry 56	**Goods & Passengers Tax**	Taxes on goods and passengers carried by road or inland waterways.
Entry 60	**Profession Tax**	Tax on professions, trades, and employment.
Entry 62	**Entertainment Tax**	Taxes on entertainment and amusements levied by local bodies like Panchayats or Municipalities.

C. Concurrent List (List III)

Both Centre and State can make laws, but there are very few tax entries here.

Entry No.	Tax Subject	Explanation
Entry 44	**Stamp Duties**	Stamp duties (fees for legal documents) other than those collected by means of judicial stamps.

3. Goods and Services Tax (GST)

To implement GST, the Constitution was amended (101st Amendment Act, 2016). This changed the old system where Centre and States had separate powers.

Article	Feature	Explanation
Article 246A	**Simultaneous Power**	This gives power to **both** the Parliament and State Legislatures to make laws regarding GST imposed by the Union or the State.
Article 269A	**IGST (Inter-State)**	When trade happens *between* states, the Centre collects the tax (IGST), but this money is shared between the Centre and the States.
Article 279A	**GST Council**	A joint forum of the Centre and States (chaired by the Union Finance Minister) that decides GST rates and rules to ensure uniformity.

4. How Tax Money is Distributed (Financial Relations)

Even if the Central Government collects a tax, it often has to share the money with States.

Article	Type of Tax Distribution	Explanation
Article	**Levied by Union,**	Taxes like stamp duties on cheques/bills are set by the Centre

268	**Collected by State**	but collected and kept by the State governments. This money does not go to the Centre.
Article 269	**Levied & Collected by Union, Given to States**	Taxes on inter-state sale of goods. The Centre collects it but assigns the revenue to the States.
Article 270	**Taxes Shared between Union and States**	Most major central taxes (like Income Tax) are collected by the Centre. The net proceeds are then divided between the Centre and States based on the Finance Commission's advice.
Article 271	**Surcharge (Extra Tax)**	The Parliament can add a "Surcharge" on certain taxes. The money from this surcharge goes **only** to the Centre; it is not shared with the States.

5. Restrictions on Taxing Powers

The Constitution also puts limits on the power to tax to protect citizens and trade.

Article	Restriction	Explanation
Article 276	**Limit on Profession Tax**	States can tax professions, but the total amount payable by one person cannot exceed **Rs. 2,500 per year**.
Article 286	**No Tax on Imports/Exports**	States cannot impose tax on the sale or purchase of goods if the transaction happens outside the state, or during import into/export out of India.
Article 289	**Exemption of State Property**	The Union (Centre) cannot tax the property or income of a State Government.
Article 301	**Freedom of Trade**	Trade, commerce, and movement throughout India should generally be free from taxes that restrict this freedom, though some reasonable restrictions are allowed.

3.3.1 Union Tax Powers

Union taxing powers are listed mainly in Entries 82 to 92B of the Union List. Some important Union tax powers include:

- Taxes on income other than agricultural income, now including corporate tax and personal income tax.
- Customs duties on imports and exports.
- Excise duties on goods manufactured or produced in India, except alcoholic liquors for human consumption and some narcotic substances which are reserved for States.
- Taxes on the capital value of assets of individuals and companies (though many such taxes have been abolished in practice).
- Service tax earlier, and now the central share of Goods and Services Tax under the GST system.

As mentioned in the previous section, the Constitution of India grants the **Union Government** (Central Government) exclusive powers to levy certain taxes. These powers are listed in **List I (Union List)** of the **Seventh Schedule** under **Article 246**.

Union List (List I) - Taxes Levied by the Central Government

Entry No.	**Name of Tax**	**Explanation**
Entry 82	**Income Tax**	This is a tax on the income earned by individuals. However, the Central Government **cannot** tax income earned from agriculture (farming).
Entry 83	**Customs Duty**	This tax is charged on goods that are **imported** into India from other countries or **exported** out of India.
Entry 84	**Excise Duty**	This is a tax on goods **manufactured or produced** within India. Specifically, it currently applies to items like petroleum products (crude oil, diesel, petrol), tobacco, and tobacco products.

Entry 85	**Corporation Tax**	This is a tax on the income or profits earned by **companies** and business organizations.
Entry 86	**Taxes on Capital Value**	This is a tax on the total value of assets (wealth) owned by individuals and companies. However, this does not apply to agricultural land.
Entry 87	**Estate Duty**	This is a tax related to the property passed on after a person's death, excluding agricultural land.
Entry 88	**Succession Duty**	Similar to Estate Duty, this is a tax on property inherited by successors, again excluding agricultural land.
Entry 89	**Terminal Taxes**	Taxes on goods or passengers carried by **railway, sea, or air**. This includes taxes on railway fares and freight charges.
Entry 90	**Stock Exchange Taxes**	Taxes on transactions made in stock exchanges (share market) and future markets, other than stamp duties.
Entry 92A	**Inter-State Trade Tax**	Taxes on the sale or purchase of goods (except newspapers) where the transaction happens **between two different states** (Inter-State trade).
Entry 92B	**Consignment Tax**	Taxes on the consignment of goods (sending goods to an agent) during Inter-State trade.
Entry 97	**Residuary Powers**	If a new type of tax arises that is **not mentioned** in the State List (List II) or Concurrent List (List III), the Central Government has the power to levy it.

Special Tax Powers Under GST (Goods and Services Tax)

Following the 101st Constitutional Amendment, new powers were introduced regarding GST.

Article	**Type of Tax Power**	**Explanation**
Article	**GST (Intra-**	Both the Parliament (Union) and State Legislatures have the power to

246A	**State)**	make laws regarding GST on transactions happening **within** a state.
Article 269A	**IGST (Inter-State)**	The Central Government has the exclusive power to levy and collect **Integrated GST (IGST)** on the supply of goods and services that happens **between states** (Inter-State trade). However, this money is shared between the Centre and States.
Article 271	**Surcharge**	The Parliament can increase certain taxes by adding a **surcharge** (an extra tax). The money collected from this surcharge goes entirely to the Centre and is not shared with the States.

3.3.2 State Tax Powers

State taxing powers are mainly found in Entries 45 to 63 of the State List. Key State tax powers include:

- Land revenue and taxes on agricultural income.
- Taxes on lands and buildings, including property tax.
- Excise duty on alcoholic liquors for human consumption and certain narcotic substances when manufactured or produced in the State.
- Taxes on the entry of goods into a local area for consumption, use or sale (entry tax or octroi in older systems).
- Taxes on vehicles, passengers and goods carried by road or inland waterways.
- Taxes on professions, trades, callings and employments, subject to a monetary ceiling.

With the introduction of GST, State powers over taxes on sale or purchase of goods, and many indirect taxes such as entertainment tax, have been merged into the new GST framework. Now States levy State Goods and Services Tax on most intra state supplies, along with their share of Integrated GST on inter-state trade.

As already mentioned in the previous section, the Constitution of India grants **State Governments** specific powers to make laws and collect taxes. These powers are primarily

listed in **List II (State List)** of the **Seventh Schedule** under **Article 246**. Additionally, the introduction of the Goods and Services Tax (GST) introduced new powers under **Article 246A**.

1. State List (List II) - Taxes Levied Exclusively by States

These are taxes where the State Legislature has the exclusive power to make laws and collect revenue.

Entry No.	Name of Tax	Explanation & Details
Entry 46	**Agricultural Income Tax**	The State Government has the power to tax income earned from farming and agriculture. The Central Government is specifically banned from taxing this income.
Entry 51	**Excise Duty on Alcohol & Narcotics**	States can charge Excise Duty (a tax on production/manufacturing) on: 1. **Alcoholic liquor** meant for human consumption. 2. **Opium, Indian hemp, and other narcotics**. *Note: This does not apply to medicinal or toilet preparations containing alcohol*.
Entry 53	**Electricity Taxes**	This is a tax on the **consumption** or **sale** of electricity within the state.
Entry 54	**Sales Tax / VAT**	Before GST, this was the main tax on selling goods. Now, States can only charge this tax on items **not covered by GST**, specifically: 1. **Petroleum products** (Crude, Diesel, Petrol, Natural Gas, Aviation Fuel). 2. **Alcoholic liquor** for human consumption.
Entry 56	**Goods & Passengers Tax**	A tax charged on goods and passengers that are carried by **road** or **inland waterways** (like rivers/canals within the state).

Entry 57	**Vehicle Tax**	Taxes on vehicles suitable for use on roads (often called Road Tax), regardless of whether they are mechanically propelled or not.
Entry 58	**Tax on Animals & Boats**	States can levy taxes on animals and boats.
Entry 60	**Profession Tax**	This is a tax on individuals based on their **professions, trades, callings, and employment**. *Restriction:* The Constitution (Article 276) limits this tax to a maximum of **₹2,500 per person per annum**.
Entry 61	**Capitation Taxes**	A tax levied on a person (a head tax), though rarely used in modern times.
Entry 62	**Entertainment & Luxury Tax**	Taxes on entertainments, amusements, betting, and gambling. These are often collected by local bodies like Panchayats or Municipalities.
Entry 63	**Stamp Duty**	Rates of stamp duty for documents other than those specified in the Union List (e.g., land and property registration within the state).

2. State Powers under GST (Goods and Services Tax)

With the 101st Constitution Amendment, the old system where Centre and States had completely separate powers was modified to allow simultaneous taxation.

Article	**Tax Name**	**Explanation**
Article 246A	**SGST (State GST)**	The State Legislature has the power to make laws regarding the Goods and Services Tax (GST). When a transaction (supply of goods or services) happens **within the state (Intra-State)**, the State collects **SGST**.

Article 269A	**Share of IGST**	When trade happens **between states (Inter-State)**, the Centre collects IGST. However, the State Government receives a share of this tax based on the recommendations of the GST Council. The tax generally goes to the **consumer state** (where the goods are consumed).

3. Taxes Levied by Union but Collected by States

Under **Article 268**, there are certain duties that are set by the Central Government (Union) but the State Governments are given the power to collect and keep the money.

Article	Feature	Explanation
Article 268	**Stamp Duties**	Duties such as **Stamp Duties** on bills of exchange, cheques, and promissory notes are levied by the Union Government. However, these are **collected and appropriated (kept)** by the State Government where the transaction takes place. This money does not go to the Consolidated Fund of India.

4. Restrictions on State Taxing Powers

The Constitution also places limits on State powers to ensure free trade and prevent conflict with the Centre.

Article	Restriction	Explanation
Article 276	**Ceiling on Profession Tax**	While States can tax professions, they cannot charge more than **₹2,500 per year** per person.
Article 286	**No Tax on Imports/Exports**	A State **cannot** impose tax on the sale or purchase of goods if the transaction takes place: 1. Outside the State. 2. During the import of goods into India or export out of India.
Article	**No Discrimination**	States can tax goods coming from other states, but they **cannot** tax them higher than similar goods manufactured inside the state.

304		There must be no discrimination.

3.3.3 Residuary and Local Tax Powers

As noted earlier, residuary powers of legislation and taxation rest with Parliament under Entry 97 of the Union List. However, local governments such as Panchayats and Municipalities also have limited tax powers. These are not detailed in the Seventh Schedule but flow from Parts IX and IX A of the Constitution, which were inserted by the 73rd and 74th Constitutional Amendments.

These parts allow State laws to give local bodies powers to levy and collect taxes, duties, tolls and fees, such as property tax, market fees and user charges for local services. This is important because it allows taxation powers to reach the grassroots level and supports local self government.

1. Residuary Tax Powers (The "Leftover" Power)

The Constitution ensures that if a new type of tax arises that is not written in any specific list, the power to collect it goes to the **Central Government** (Parliament). This is known as Residuary Power.

Feature		**Explanation**
Authority	**Central Government (Union)**	Only the Parliament in Delhi can make laws on these taxes.
Constitutional Reference	**Entry 97 of Union List (List I)**	This entry covers any matter or tax that is **not mentioned** in the State List (List II) or the Concurrent List (List III).
Need	**Future-Proofing**	It ensures that if a new economic activity arises (like Gift Tax or Expenditure Tax in the past), the government has a clear rule on who can tax it without amending the Constitution every time.

Example	**Service Tax (Historical)**	Before specific amendments were made, taxes on services were levied using this residuary power because "Services" were not originally listed in the 7th Schedule.

2. Local Tax Powers (Municipalities and Panchayats)

Local bodies do not have a separate "List" in the 7th Schedule like the Union or State. However, the sources highlight that they derive power to tax from State laws or specific Constitutional articles.

Feature	**Constitutional Reference**	**Explanation**
Property Tax	**Delegated Power**	The power to tax land and buildings belongs to the State, but it is **delegated by law** to local bodies (Municipalities). The law specifies how to value the property and collect the tax.
Entertainment Tax	**Entry 62 (State List)**	This entry allows taxes on entertainment and amusements to be **levied and collected** by a Panchayat, Municipality, or District Council.
Profession Tax	**Article 276**	Local authorities (and States) can tax professions, trades, and employment. However, the total tax on one person cannot exceed **₹2,500 per year**.
Old/Existing Taxes	**Article 277**	If a local authority (like a Municipality) was collecting a specific tax **before the Constitution started**, it can continue to collect it, even if that tax now belongs to the Union List. This continues until Parliament makes a new law to stop it.
General Fees	**General Practice**	Local governments and municipalities often impose small fees and levies to fund their functioning and public services.

CHECK YOUR PROGRESS

Q1. What is the basic principle laid down in Article 265 of the Constitution regarding taxation

Q2. Name any two important tax entries in the Union List and any two in the State List.

3.4 ARTICLES RELATED TO FINANCE AND TAXATION

The Constitution of India lays down specific provisions regarding how the government can earn money (revenue), keep it, and spend it. These are primarily found in Part XII of the Constitution. The following table summarizes these key articles in simple words.

Article	Subject Matter	Explanation
Art. 265	**No Tax Without Law**	The government cannot charge or collect any tax unless there is a specific law passed by the Parliament or State Legislature authorizing it.
Art. 266	**Consolidated Fund**	All revenues received, loans raised, and money received in repayment of loans by the Government form this fund. No money can be taken out of this fund without government approval.
Art. 267	**Contingency Fund**	A fund kept for emergencies or unforeseen circumstances. The President can use this fund pending authorization by Parliament.
Art. 268	**Duties by Union, Collected by States**	Certain stamp duties are set by the Central Government but are collected and kept by the State Governments.
Art. 269	**Inter-State Trade Taxes**	Taxes on the sale or purchase of goods (other than newspapers) during inter-state trade are set and collected by the Centre but assigned (given) to the States.
Art. 269A	**GST on Inter-State Trade**	Goods and Services Tax (GST) on supplies between states is collected by the Centre but shared between the Centre and States based on GST Council recommendations.
Art.	**Taxes Distributed between Union**	Most taxes collected by the Union (like Income Tax) are

270	**&States**	distributed between the Central Government and the States.
Art. 271	**Surcharge**	The Parliament can add an extra tax (surcharge) on certain duties. The money from this surcharge goes entirely to the Centre and is not shared with States.
Art. 275	**Grants from Union**	The Parliament can provide financial help (grants-in-aid) to specific States that are in need of assistance.
Art. 276	**Profession Tax**	State governments or local bodies can tax professions, trades, and employments. The maximum limit is currently ₹2,500 per person per year.
Art. 279A	**GST Council**	Empowers the President to constitute a Council to make recommendations to the Union and States on GST rates and rules.
Art. 280	**Finance Commission**	A commission set up every 5 years to recommend how tax revenues should be shared between the Centre and States.
Art. 286	**Restrictions on Tax**	States cannot tax the sale/purchase of goods if it happens outside the state or during import/export.
Art. 289	**Exemption of State Property**	The property and income of a State are exempt from Union taxation.

3.4.1 General Principles and Authority to Tax

A core principle of constitutional taxation is in Article 265. It states that no tax shall be levied or collected except by authority of law. This means that every tax must be backed by a valid law made by Parliament or a State Legislature. It protects citizens from arbitrary exactions by the executive.

Article 246, read with the Seventh Schedule, sets the distribution of legislative powers, including taxation, between Parliament and State Legislatures. Article 248 and Entry 97 of the Union List confirm the residuary power of Parliament, including in taxation.

Article 266 provides for the Consolidated Fund of India and of each State, as well as the Public Account. All revenues received by the Government of India, including proceeds of taxes, and all loans raised, form the Consolidated Fund of India. Similarly, State revenues constitutes the Consolidated Fund of the State. No money can be withdrawn from these funds except according to law and after due appropriation by Parliament or the State Legislature.

Article 267 allows creation of Contingency Funds by Parliament and State Legislatures to meet urgent and unforeseen expenditure.

The authority to tax in India is derived strictly from the Constitution. It is not an arbitrary power of the government but a structured legal process.

1. The Fundamental Rule: Authority of Law (Article 265): The most important principle is that **"No tax shall be levied or collected except by authority of law"**.The government cannot demand money from citizens just by issuing an executive order or a simple notice. They must pass a proper Act (Statute) in the Parliament or State Assembly.

• **Levy and Collection:** This protection applies to both the charging of the tax (levy) and the procedure of gathering the money (collection). If a tax is collected without a valid law, it is considered unconstitutional.

2. Distribution of Taxing Power (Article 246): To avoid conflict between the Central Government (Union) and State Governments, Article 246 divides the power to make laws and tax into three lists found in the **Seventh Schedule** of the Constitution.

• **Union List (List I):** Only the Central Government (Parliament) can tax these items.

◦ **Income Tax:** Tax on income other than agricultural income.

◦ **Customs Duty:** Tax on imports and exports.

◦ **Excise Duty:** Tax on goods manufactured in India (currently applicable to petroleum, tobacco, etc.).

◦ **Corporation Tax:** Tax on the income of companies.

◦ **Residuary Power (Entry 97):** Any tax not mentioned in the State or Concurrent lists belongs to the Centre (e.g., formerly Service Tax).

• **State List (List II):** Only the State Governments can tax these items.

◦ **Agricultural Income Tax:** States have the exclusive right to tax income from farming.

◦ **Excise on Alcohol:** Tax on liquor for human consumption produced within the state.

◦ **Sales Tax/VAT:** Tax on the sale of petroleum and alcohol within the state.

◦ **Taxes on Professions:** Taxes on employments and trades (subject to limits).

• **Concurrent List (List III):** Both Centre and State can make laws, but generally, this list does not contain major taxing powers, focusing more on general laws like criminal law or marriage.

3. Goods and Services Tax (Article 246A): With the introduction of GST (101st Amendment), a special provision was added. Article 246A gives **simultaneous power** to both the Parliament and State Legislatures to make laws regarding GST on transactions that happen *within* a state.

4. Distinction between Tax and Fee: While the Constitution requires a law for "Tax," there is a legal difference between a tax and a fee.

• **Tax:** A compulsory contribution to the government for general public expenses. It is not a voluntary payment.

• **Fee:** A payment collected for a specific service rendered. Fees are usually kept by the specific department providing the service rather than being distributed among all taxpayers.

3.4.2 Distribution of Tax Revenues

Articles 268 to 272 deal with the distribution of revenues between the Union and the States.

- Article 268 covers certain duties such as stamp duties and excise duties on medicinal and toilet preparations that are levied by the Union but collected and used by the States.
- Article 269 relates to taxes on the sale or purchase of goods in the course of interstate trade or commerce and taxes on interstate consignment of goods which were levied and collected by the Union but assigned to the States, subject to certain conditions. After GST this article has been revised for taxes on interstate supplies of goods and services.
- Article 269A, inserted through the 101st Amendment, deals specifically with the levy and collection of GST on interstate supplies. The tax is collected by the Government of India

but apportioned between the Union and the States according to a law based on recommendations of the GST Council.

- Article 270 provides for sharing of taxes between the Union and the States. It states that taxes referred to in the article shall be levied and collected by the Government of India and distributed between the Union and the States in such manner as prescribed, on the recommendations of the Finance Commission. Income tax and the divisible pool of central taxes fall here.
- Article 271 allows Parliament to levy a surcharge on certain duties and taxes for purposes of the Union. Such surcharge forms part of the Consolidated Fund of India and is not shareable with the States unless otherwise provided.
- Article 272, which earlier dealt with sharing of Union excise duties, was omitted by the 80th Amendment when the scheme of sharing was changed to a share in the entire divisible pool of central taxes.

Articles 275 and 282 cover grants in aid and other forms of financial assistance from the Union to the States. Article 275 allows Parliament to make grants in aid of the revenues of such States as Parliament may decide, especially for promoting the welfare of Scheduled Tribes and for special needs of certain States.

3.4.3 Protection for Certain Union and State Interests

Articles 285 and 289 protect the tax immunity of Union and State property and income, with some exceptions. Article 285 says that property of the Union is exempt from all taxes imposed by a State, unless Parliament provides otherwise. Article 289 provides that the property and income of a State is exempt from Union taxation, except in respect of trade or business carried on by the State. These provisions aim to prevent one level of government from taxing the essential property and income of another in a way that harms federal balance.

Articles 286 and 304 impose restrictions on State taxation of goods that move in inter state commerce or on imports and exports, to protect freedom of trade, commerce and intercourse throughout the territory of India. These provisions have been revised over time to fit the new indirect tax system with GST.

1. Protection of State Property from Union Taxation (Article 289)

The Constitution provides a specific shield to State Governments to protect their assets and income from being taxed by the Central Government.

• **General Rule:** According to **Article 289**, the property and income of a State are exempt from Union taxation. This means the Central Government generally cannot demand tax on the revenue earned by a State Government or the buildings/land owned by it.

• **Exception to the Rule:** However, this protection is not absolute. The sources clarify that the Union can tax the property or income of a State if that income comes from a trade or business run by the State. This applies only to the degree permitted by legislation passed by the Parliament.

This ensures that the sovereign functions of the State are not burdened by Central taxes, while commercial activities can still be regulated by Parliament.

2. Restrictions on State Powers to Protect Union Interests (Article 286)

To protect the Union's control over international trade and to ensure uniformity, the Constitution places limits on the State's power to charge sales tax.

• **No Tax on Import/Export:Article 286** restricts the power of the State to impose taxes on the sale or purchase of goods if the transaction takes place during the process of **import** into India or **export** out of India. This protects the Union's exclusive right to manage foreign trade (Customs).

• **No Tax Outside the State:** A State cannot tax a sale or purchase that happens **outside** that specific State.

• **Goods of Special Importance:** Parliament has the power to declare certain goods as having "special importance" for inter-state trade. Once declared, the State Government's ability to tax these goods is restricted by laws made by Parliament, such as the Central Sales Tax Act, 1956.

3. Protection of Trade and Commerce (Articles 301 & 304)

The Constitution protects the interest of free trade throughout India to prevent States from creating trade barriers.

• **Freedom of Trade:Article 301** states that trade, commerce, and intercourse throughout India shall be free. This essentially means taxes should not be used to block the movement of goods.

• **Non-Discrimination:** Under **Article 304**, a State can tax goods coming from other states, but it cannot discriminate. It cannot charge a higher tax on imported goods than it charges on similar goods manufactured inside the State. This protects manufacturers in other states from unfair treatment.

4. Protection of Union's Income Tax Base (Article 276)

The Constitution allows States to collect a "Profession Tax," but it sets a limit to protect the Union's exclusive right to collect "Income Tax."

• **Profession Tax Limit:Article 276** allows States or local bodies to tax professions, trades, callings, and employments. However, to ensure this does not become a second "Income Tax" (which is a Union power under Entry 82), the Constitution sets a maximum ceiling.

• **Maximum Amount:** The total amount payable by any single person for profession tax cannot exceed **Rs. 2,500 per annum**.

5. Saving of Pre-Constitutional Taxes (Article 277)

This provision protects the financial interest of States and Local bodies regarding old taxes.

• **Saving Clause:Article 277** allows that taxes, duties, cesses, or fees that were being lawfully levied by a State or Municipality *before* the Constitution started can continue to be levied.

• **Union List Exception:** These taxes can continue even if those items are now mentioned in the **Union List** (meaning only the Centre should tax them). They can continue until Parliament makes a new law to stop them.

Table: Protection of Tax Interests

Article	Who is Protected?	Subject Matter	Simple Explanation
Art. 289	**State Interest**	**Exemption of State Property**	The Central Government cannot tax the property or income of a State Government, except for business activities authorized by Parliament.

Art. 286	**Union Interest**	**Restrictions on Sales Tax**	States cannot tax the sale of goods if the transaction happens outside the state or during import/export (International trade).
Art. 276	**Union Interest**	**Limit on Profession Tax**	States can tax professions, but the amount is capped at **Rs. 2,500 per year** to prevent it from overlapping with the Union's Income Tax.
Art. 277	**State/Local Interest**	**Saving of Old Taxes**	Taxes collected by locals/states before the Constitution can continue even if they now belong to the Union list, until Parliament stops them.
Art. 304	**Trade Interest**	**Non-Discrimination**	States cannot tax goods from other states higher than they tax their own local goods.

3.5 FINANCE COMMISSION AND ITS ROLE

Article 280 of the Constitution provides for a Finance Commission to be appointed by the President every five years or earlier. It is a constitutional body, not a permanent one, and its task is to make recommendations on the financial relations between the Union and the States.

The Finance Commission has to recommend:

- The distribution between the Union and the States of the net proceeds of taxes that are to be shared (vertical devolution).
- The allocation between the States of their share of such proceeds (horizontal distribution).
- The principles which should govern grants in aid of the revenues of the States out of the Consolidated Fund of India.
- Measures needed to augment the Consolidated Fund of a State to supplement the resources of Panchayats and Municipalities based on State Finance Commission recommendations.

Because of these functions, the Finance Commission is often called the balancing wheel of fiscal federalism in India. It aims to reduce vertical imbalances (between Union resources and

State responsibilities) and horizontal imbalances (between richer and poorer States) by recommending fair sharing formulas.

Recent Finance Commissions, such as the 14th and 15th, have recommended significant increases in the share of States in the divisible pool, and have also introduced performance-based incentives related to fiscal discipline, demographic changes and other indicators. While the President and Parliament are not legally bound to accept all recommendations, they carry great weight because of the Commission's constitutional status and expert nature.

3.6 CONSTITUTIONAL AMENDMENTS RELATED TO TAXATION

The constitutional framework of taxation has not remained static. Several amendments have reshaped how taxes are levied, collected and shared.

3.6.1 Evolution before GST

Earlier amendments focused on improving revenue sharing and clarifying tax powers. The 73rd and 74th Amendments gave constitutional status to Panchayats and Municipalities and allowed States to empower them with local tax powers.

The 80th Amendment (2000) changed the method of sharing Union taxes with States. It replaced separate sharing of income tax and Union excise duties with a share in the net proceeds of all central taxes in the divisible pool, as recommended by the Tenth Finance Commission. This gave States a more stable share of Union tax revenues.

The 88th Amendment created a specific entry for service tax in the Union List, but this was later overtaken by the design of GST under the 101st Amendment which gave concurrent taxing powers for GST to both Union and States.

Evolution of Taxation Before GST

Stage / Era	**Key Tax / Event**	**Explanation**
British India (1860)	**First Income Tax**	The tax system was started by **James Wilson**, the first Finance Minister of the British Indian Government. He introduced India's first Income Tax in **1860**.

Central Level Taxes (Pre-GST)	**Excise Duty**	The Central Government collected this tax on the **manufacturing** or production of goods inside India. It was also known as **CENVAT** (Central Value Added Tax).
	Service Tax	Initially, services were not taxed. Later, the government started taxing services like telephones, stock brokerage, and insurance. This tax was collected by the Central Board of Excise and Customs.
	Customs Duty	A tax charged on goods coming into India (Import) or going out of India (Export). This was used to control international trade.
State Level Taxes (Pre-GST)	**Sales Tax / VAT**	The State Governments charged tax on the sale of goods. Because the old system was poor, **Value Added Tax (VAT)** was introduced. It was easier to manage because it had built-in mechanisms to monitor itself.
Constitutional Changes	**88th Amendment (2003)**	A specific Article (**268A**) was added to the Constitution to include **Service Tax**. However, this was later removed/omitted when the GST laws (101st Amendment) were introduced.
Inter-State Trade	**CVD & CST**	Before GST, when goods moved between states, taxes like **CVD (Countervailing Duty)** were used to protect domestic producers. There were separate taxes for buying and selling across state borders.
The Problem	**Cascading Effect**	Before GST, there were multiple taxes from the Centre and States separately. This caused a **"domino impact"** or cascading effect (tax on tax), making the system confusing and non-uniform.
The Result	**Shift to GST**	To fix these problems, the **101st Constitution Amendment Act, 2016** was passed. This replaced the old multiple taxes with a single **Goods and Services Tax (GST)** effective from

		July 1, 2017.

3.6.2 The 101st Constitutional Amendment and GST

The 101st Constitutional Amendment, which came into force in 2016, is one of the most important tax reforms in India. It created the framework for the Goods and Services Tax, which replaced many indirect taxes of the Union and the States with a unified system.

The amendment introduced new Articles 246A, 269A and 279A, and amended several other provisions. Article 246A gives Parliament and the State Legislatures concurrent power to make laws with respect to GST. Parliament has exclusive power over inter state supplies.

Article 269A deals with GST on inter state trade and commerce. Such tax is levied and collected by the Government of India and apportioned between the Union and the States as per a law recommended by the GST Council.

Article 279A establishes the GST Council, a joint forum of Union and State Finance Ministers, chaired by the Union Finance Minister. It makes recommendations on important matters such as tax rates, exemptions, threshold limits, special provisions for States and the model GST laws.

The 101st Amendment also made changes in Articles 268, 269, 270 and 271, and deleted some old entries in the Union and State Lists to fit the new system. The main objective was to create a common national market by having a destination-based tax on consumption with a uniform structure, while still giving both Union and States a defined role and share in indirect tax revenues.

Historically, before the GST regime, India’s tax system was complicated. The power to tax was strictly divided: the **Central Government** taxed the *manufacturing* of goods (Excise Duty) and services (Service Tax), while the **State Governments** taxed the *sale* of goods (VAT/Sales Tax). This separation meant that the Centre could not tax sales, and States could not tax services. This system caused a "cascading effect," meaning there was a "tax on tax," which increased the cost of goods. To fix this and create a "One Nation, One Tax" system, the **101st Constitution Amendment Act, 2016** was passed, which came into effect on **July 1, 2017**.

The New Power to Tax (Article 246A)

The most significant change brought by the 101st Amendment was the introduction of **Article 246A**.

• **Simultaneous Power:** Previously, powers were separate. This new article gave special powers to **both** the Parliament (Centre) and the State Legislatures to make laws regarding GST.

• **Mechanism:** This allows both the Centre and the State to tax the same transaction. For example, if you buy something within your state (Intra-State trade), two taxes are levied: **CGST** (Central GST) and **SGST** (State GST). This article ensures both governments have the legal authority to do this.

Handling Trade Between States (Article 269A)

When goods or services are sold from one state to another (Inter-State trade), the rules are different to avoid confusion.

• **IGST:** Under **Article 269A**, the Central Government has the exclusive power to levy and collect the **Integrated Goods and Services Tax (IGST)** on inter-state trade.

• **Sharing the Money:** Although the Centre collects the IGST, it does not keep all of it. The money is **apportioned** (shared) between the Union and the States based on the recommendations of the GST Council.

• **Imports:** This article also clarifies that importing goods or services into India is treated as inter-state trade, so IGST applies to imports as well.

GST Council (Article 279A)

To ensure that the Centre and all States agree on tax rates and rules, the Amendment inserted **Article 279A**. This empowers the President to set up the **GST Council**.

• **Composition:** The Council is a joint forum. It is chaired by the **Union Finance Minister**. Its members include the Union Minister of State for Finance and Ministers from each State Government.

• **Power:** The Council decides on important matters like tax rates, which goods are exempt from tax, and the rules for GST.

• **Voting:** Decisions are not made by the Centre alone. The Central Government has a vote weightage of **one-third**, while all State Governments together have a weightage of **two-thirds**. Decisions require a **three-fourths majority**, forcing the Centre and States to work together.

Distribution of Revenue (Article 270)

The Amendment also changed **Article 270**, which deals with how tax money is distributed. It now ensures that the GST collected by the Union Government is distributed between the Union and the States. This was done to ensure States have adequate financial resources to discharge their responsibilities.

Check your progress

Q3. What is the main constitutional role of the Finance Commission of India

Q4. How did the 80th Constitutional Amendment change the sharing of Union taxes with the States

Q5. What key change was brought by the 101st Constitutional Amendment with respect to Goods and Services Tax

3.7 LET US SUM UP

In this unit we studied how the Constitution of India provides a detailed and structured framework for taxation. The division of legislative powers in Article 246 and the Seventh Schedule clearly separates Union and State taxing powers, with the Union List entries 82 to 92B and the State List entries 45 to 63 defining who can tax what. There are no concurrent tax powers, which avoids double taxation by two legislatures on the same base. At the same time the residuary powers of taxation stay with Parliament, and limited tax powers are also passed down to local bodies through later constitutional amendments.

We also saw that Part XII of the Constitution, especially Articles 265 to 289, contains basic rules on authority to tax, distribution of revenues, tax immunities and grants in aid. Article 265 protects citizens by insisting that no tax can be levied or collected without authority of law. Other articles like 268 to 272 and 270, together with Article 280, create a system in which the proceeds of certain taxes are shared between Union and States on the basis of Finance Commission recommendations. The Finance Commission acts as a balancing wheel of fiscal federalism. Further, key amendments such as the 80th and 101st have modernised this

framework by broadening the divisible pool and by introducing GST with concurrent taxing powers and a GST Council. Together these provisions show how the Constitution supports both strong national finances and meaningful State autonomy within a cooperative federal structure.

3.8FURTHER READINGS

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3.9ANSWERS TO CHECK YOUR PROGRESS

Ans to Q1: Article 265 says that no tax shall be levied or collected except by authority of law. This means every tax must be created and collected under a valid law made by a competent legislature.

Ans to Q2: Two Union List tax entries include taxes on income other than agricultural income, and customs duties on imports and exports. Two State List entries include taxes on agricultural income and taxes on lands and buildings.

Ans to Q3: The Finance Commission recommends how the net proceeds of certain central taxes should be shared between the Union and the States and among the States themselves, and suggests principles for grants in aid to States.

Ans to Q4: The 80th Amendment replaced separate sharing of income tax and Union excise duties with a fixed share of States in the net proceeds of all central taxes in the divisible pool, as recommended by the Tenth Finance Commission.

Ans to Q5: The 101st Amendment created the constitutional framework for Goods and Services Tax by inserting Article 246A giving concurrent powers to Union and States to levy GST and adding Article 269A and 279A to manage inter state GST and the GST Council.

2.9 FURTHER READING

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3.10MODEL QUESTIONS

1. Explain how the Constitution of India distributes taxing powers between the Union and the States. Give suitable examples from the Union and State Lists.
2. Discuss the constitutional provisions that govern the distribution of tax revenues between the Union and the States.
3. Describe the composition, constitutional status and main functions of the Finance Commission of India. Why is it called the balancing wheel of fiscal federalism
4. Examine the impact of the 80th and 101st Constitutional Amendments on the scheme of taxation and revenue sharing in India.

5. What safeguards does the Constitution provide to prevent arbitrary taxation and to protect the financial autonomy of States and the Union respectively

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UNIT 4: CLASSIFICATION AND STRUCTURE OF TAXES IN INDIA

UNIT STRUCTURE

4.1 Learning Outcomes

4.2 Introduction

4.3 Meaning of Direct Tax

4.3.1 Direct Taxes imposed in India

4.4 Meaning of Indirect Tax

4.4.1 Indirect Taxes earlier imposed in India

4.5 GST as an Indirect Tax

4.6 Regressive, Proportional, and Progressive taxes: an overview

4.6.1 Specific Vs ad Valorem taxes

4.7 GST structure

4.7.1Key Aspects of the Unified GST structure

4.8 Tax Structure comparison with developed nations like US, UK.

4.9 Tax Incidence and Tax impact

4.9.1 Tax impact

4.9.2 Tax incidence

4.10 Let Us Sum Up

4.11 Model Questions

4.12 Future Reading

4.1 LEARNING OUTCOMES

After completing this unit, learners will be able to:

- Understand the classification of taxes in India and the difference between direct and indirect taxes.
- Distinguish between progressive, proportional, and regressive tax systems.
- Explain the difference between specific taxes and ad valorem taxes.
- Analyze the concepts of tax incidence and tax impact.
- Understand the basic concept of GST as a unified tax structure in India.
- Compare the tax structure of India with developed countries such as the United States and the United Kingdom

4.2 INTRODUCTION

Taxation is a vital source of revenue for the government and plays an important role in economic development. This unit introduces the classification and structure of taxes in India, focusing on the basic concepts rather than detailed laws. It explains the difference between direct and indirect taxes and various tax structures such as progressive, proportional, and regressive taxes. The unit also discusses specific and ad valorem taxes and the concepts of tax incidence and tax impact. Further, it provides a conceptual overview of GST as a unified tax system in India. Finally, the chapter compares India's tax structure with developed countries like the US and UK, helping students understand global tax practices.

Tax is a compulsory charge collected by the Central and State Governments from individuals and businesses to meet public expenses and support economic development. Taxes are mainly classified into direct taxes and indirect taxes. Direct taxes are paid directly by individuals on

their income or earnings to the government. Indirect taxes are collected when goods or services are purchased and are included in their price.

4.3 MEANING OF DIRECT TAX

A direct tax is a tax charged directly on a person's income, profits, or wealth. The burden of a direct tax is borne by the same person on whom it is imposed and cannot be shifted to others. Examples include income tax and corporate tax. In India, direct taxes are administered by the Central Board of Direct Taxes.

4.3.1 Direct Taxes Imposed in India

Some important direct taxes in India are as follows:

1. Income Tax

Income tax is charged on the income earned by individuals, Hindu Undivided Families (HUFs), and other taxpayers. Individuals are taxed according to income tax slabs, which increase as income increases.

2. Corporate Tax

Corporate tax is paid by companies that are registered in India or operate in India. It is charged on the **profits earned by companies**. Unlike individuals, companies pay tax at **fixed rates** prescribed by the government.

3. Securities Transaction Tax (STT)

STT is levied on transactions involving securities such as shares when traded on a recognised stock exchange. It is charged over and above the transaction value, thereby increasing the cost of trading.

4. Wealth Tax (Abolished in 2015)

Wealth tax was earlier imposed on individuals with net wealth above a specified limit. It was abolished in 2015 and replaced by a **surcharge on high-income individuals**.

5. Estate Duty (Abolished in 1985)

Estate duty was earlier charged on the transfer of wealth through inheritance. This tax was abolished in 1985.

4.4MEANING OF INDIRECT TAX

An indirect tax is a tax charged by the government on goods and services. The burden of this tax can be passed from one person to another. For example, a wholesaler passes the tax to the retailer, and the retailer passes it to the final customer. Therefore, the final consumer ultimately bears the burden of indirect taxes. In India, indirect taxes are administered by the Central Board of Indirect Taxes and Customs.

Earlier, indirect taxes meant that consumers paid more than the actual cost of goods or services due to multiple taxes being charged at different stages. Many different indirect taxes were imposed before the introduction of GST.

4.4.1 Indirect Taxes Earlier Imposed in India

Before GST, the following indirect taxes were levied in India:

- **Customs Duty**: Levied on goods imported from other countries and ultimately borne by Indian consumers.
- **Central Excise Duty**: Charged on manufacturers, who shifted the tax burden to wholesalers and retailers.
- **Service Tax**: Imposed on services provided and paid by the service recipient.
- **Sales Tax**: Paid by retailers and passed on to customers while selling goods.
- **Value Added Tax (VAT)**: Collected on the value added at each stage of production or distribution and finally paid by consumers.

4.5 GST AS AN INDIRECT TAX

Goods and Services Tax (GST) is the present indirect tax system in India. It has replaced many earlier indirect taxes and simplified the tax structure. GST follows the principle of “One Nation, One Tax, One Market”, making taxation uniform across the country.

One major benefit of GST is the removal of the cascading effect of tax, also known as tax on tax. Earlier, tax was charged on an already taxed value, increasing the final price. Under GST, this problem is removed through input tax credit, reducing the tax burden on consumers and lowering prices.

4.6 REGRESSIVE, PROPORTIONAL, AND PROGRESSIVE TAXES : AN OVERVIEW

Taxes can be classified into regressive, proportional, and progressive based on how the tax burden affects people with different income levels.

- **Progressive Tax**

  A progressive tax is a tax in which the tax rate increases as the income of the taxpayer increases. Higher-income individuals pay a higher percentage of their income as tax. This type of tax aims to place a greater burden on the wealthy. *Example: Income tax.*

- **Proportional Tax**

  A proportional tax, also called a flat tax, is one in which the same tax rate is charged on all income levels. Every taxpayer pays the same percentage of income as tax, regardless of how much they earn. *Example: Flat occupational tax.*

- **Regressive Tax**

  A regressive tax is a tax that places a heavier burden on low-income individuals than on high-income individuals. The tax rate does not decrease with lower income, so poorer people spend a larger share of their income on tax. *Example: Indirect taxes like excise duty.*

4.6.1 Specific Vs Ad Valorem Taxes

A specific tax is charged on goods or services on a per unit basis, such as per kilogram or per packet. An ad valorem tax is charged as a percentage of the value or price of the product. The choice between specific and ad valorem taxes is often debated. Specific taxes do not adjust automatically with inflation, so their impact reduces when prices rise. Most broad-based taxes are imposed as ad valorem taxes and may be charged at a single stage or multiple stages. In multi-stage taxation, tax is levied on value added, as in the case of VAT and GST. In some cases, both specific and ad valorem taxes are combined, such as tobacco taxation under the GST regime in India.

As an economy develops from a traditional to a modern stage, the structure of tax revenue also changes. In traditional economies, taxes on land, property, and trade are dominant. During the transitional stage, indirect taxes like excise duty and sales tax become more important due to growth in manufacturing and trade. In modern economies with a strong service sector, tax revenue mainly comes from direct taxes like income tax, while commodity taxes play a smaller role.

4.7GST STRUCTURE

The Goods and Services Tax (**GST**) is a unified, multi-stage, destination-based tax that replaced numerous indirect taxes in India to create a single national market. It aims to simplify the tax structure, eliminate the cascading effect of "tax on tax," and streamline compliance processes across the country.

4.7.1Key Aspects of the Unified GST Structure

- **Subsumed Multiple Taxes**: GST integrated a wide array of central and state indirect taxes under a single umbrella, such as Central Excise Duty, Service Tax, VAT (Value Added Tax), Entry Tax, and others.
- **"One Nation, One Tax" Ideology**: It ensures that tax rates and procedures are common across the nation, fostering a seamless national market and reducing tax-induced distortions that previously existed between states.
- **Dual GST Model**: India adopted a dual GST structure, where both the Central Government and State Governments levy tax simultaneously on intra-state supplies (as **CGST** and **SGST** respectively). For inter-state transactions, an **IGST** is levied by the Centre and apportioned to the destination state.
- **Elimination of Cascading Effect**: The system allows businesses to claim an input tax credit (ITC) for taxes paid on inputs at each stage of the supply chain, which can be set off against the final tax liability. This prevents the compounding of taxes and ultimately reduces the overall tax burden on the final consumer.
- **Simplified Online Procedures**: The entire process, from registration and return filing to tax payments and refunds, is conducted through a unified online portal (GST portal), which has greatly simplified compliance and increased transparency.

This unified system replaced the complex, fragmented tax landscape that existed prior to **July 1, 2017**, making tax administration simpler and promoting economic integration

4.8 TAX STRUCTURE COMPARISON WITH DEVELOPED NATIONS LIKE US, UK.

India's tax structure differs from that of the UK and US in its combination of a centralized, slab-based income tax system, a unified Goods and Services Tax (GST), and generally lower top marginal tax rates for individuals (before surcharges), though effective rates can be comparable for very high earners.

Feature	India	United States (US)	United Kingdom (UK)
Income Tax (Top Marginal Rate)	30% (excluding surcharge/cess; effective max of ~39%)	37% (federal, plus potential state/local taxes up to 13.3%)	45% (on income over £125,140)
Corporate Tax (Main Rate)	25% or 30% (depending on turnover/regime)	21% (flat federal rate, plus state taxes)	25% (on profits over £250,000)
Consumption Tax	Goods and Services Tax (GST) (multiple slabs: 0% to 28%)	Sales tax (varies widely by state/locality, typically 0-10% at final sale)	Value Added Tax (VAT) (20% standard rate, single rate structure)
Capital Gains Tax (Long-term on shares)	10% (on gains over specific exemption limits)	0% to 20% (federal rate)	10% to 20% (higher for residential property gains)

4.8.1 Key Differences among the Countries-

- Tax System Structure: India operates a largely centralized tax system with a single income tax levied by the Central Government. In contrast, the US has a federal system supplemented by varied state and local income taxes, leading to significant geographical

differences in tax burdens. The UK system is more centralized nationally but has variations for different parts of the UK (e.g., Scotland has some different income tax bands).

- Indirect Taxation: India unified its indirect taxes under the Goods and Services Tax (GST), which uses a multi-slab structure (e.g., 5%, 12%, 18%, and 28%). The UK uses a single standard Value Added Tax (VAT) rate of 20%. The US is one of the few countries without a federal VAT or GST, relying instead on state-level sales taxes which vary widely and are only applied at the final point of sale.
- Progressivity and Rates: While all three nations have progressive income tax systems, the UK has the highest top marginal rate. India's maximum rate is technically lower at 30%, but surcharges and a health and education cess can push the effective maximum rate to around 39% for the highest earners, making it comparable to, or in some cases, slightly higher than the effective US rates for certain high-income brackets.
- Residency Rules: The US notably follows citizenship-based taxation, meaning citizens must file and potentially pay US taxes on worldwide income regardless of where they reside. Both India and the UK generally follow a residency-based system

4.9TAX INCIDENCE AND TAX IMPACT

Tax incidence and tax impact are important concepts in public finance that explain who pays a tax and who ultimately bears its burden. These concepts help in understanding the real economic effect of taxation on different sections of society.

4.9.1 Tax Impact

Tax impact refers to the initial or statutory burden of a tax. It indicates the person or entity on whom the tax is legally imposed by the government and who is required to pay the tax to the tax authorities in the first instance.

For example, in the case of GST, the seller or service provider is legally responsible for paying tax to the government. Therefore, the tax impact falls on the seller. Tax impact is fixed by law and does not change, irrespective of who ultimately bears the burden.

4.9.2 Tax Incidence

Tax incidence refers to the final burden of a tax, that is, the person who actually bears the economic burden of the tax after it has been shifted. It shows where the tax burden finally rests.

In indirect taxes, although the seller pays the tax to the government, it is added to the price of goods or services. As a result, the consumer ultimately bears the tax burden, so the tax incidence falls on the consumer.

Basis	Tax Impact	Tax Incidence
Meaning	Refers to the initial burden of tax imposed by the government	Refers to the final burden of tax borne by a person
Nature	Legal / statutory in nature	Economic in nature
Who pays?	Person who is legally required to pay tax to the government	Person who ultimately bears the cost of tax
Shifting of burden	Cannot be shifted, as it is fixed by law	Can be shifted, especially in indirect taxes
Applicability in direct tax	Impact and incidence fall on the same person	Impact and incidence fall on the same person
Applicability in indirect tax	Impact falls on the seller or producer	Incidence falls on the consumer
Example	Seller pays GST to the government	Consumer bears GST through higher prices

CHECK YOUR PROGRESS

A. FILL IN THE BLANK-

1. Taxes are broadly classified into _____ and _____ taxes.
2. Direct taxes are paid _____ to the government.
3. The burden of indirect tax is finally borne by the _____.
4. Income tax follows the principle of _____ taxation.

5. A tax charged per unit of goods is called a _____ tax.
6. GST has removed the _____ effect of tax.
7. Tax incidence refers to the _____ burden of tax.
8. VAT and GST are examples of _____ stage taxes.
9. A proportional tax is also known as a _____ tax.
10. In modern economies, revenue mainly comes from _____ taxes.

B. ANSWERS –

1. Direct, Indirect 2. Directly 3. Consumer 4. Progressive 5.Specific 6.Cascading 7. Final 8. Multi 9. Flat 10. Direct.

C. VERY SHORT ANSWER QUESTIONS-

1. What is a direct tax?
2. Define indirect tax.
3. What is tax incidence?
4. What is a proportional tax?
5. What is GST?

ANSWER TO CGECK YOU PROGRESS

Answer to Q1- Direct Tax- A direct tax is a tax imposed directly on a person's income, profits, or wealth, and its burden cannot be transferred to others.

Answer to Q2- Indirect Tax: An indirect tax is a tax levied on goods and services, the burden of which can be passed on to the final consumer.

Answer to Q3- Tax Incidence: Tax incidence refers to the final burden of a tax, that is, the person who ultimately bears the tax.

Answer to Q4- Proportional Tax: A proportional tax is a tax in which the same rate of tax is charged on all income levels, irrespective of income.

Answer to Q5- GST: Goods and Services Tax (GST) is a unified indirect tax levied on the supply of goods and services in India under the principle of “One Nation, One Tax.

4.10 LET US SUM UP

- Taxation is a compulsory contribution collected by governments to finance public services and support economic development.
- Taxes in India are mainly classified into direct taxes (borne by the same person on whom they are imposed, e.g., income tax, corporate tax) and indirect taxes (passed on through prices, e.g., GST, customs duty).
- The introduction of GST replaced multiple indirect taxes, reduced the cascading effect through input tax credit, and created a unified national market under the principle of “One Nation, One Tax.”
- Taxes may be progressive, proportional, or regressive, depending on how the burden changes with income, reflecting different approaches to equity and redistribution.
- Specific taxes are levied per unit, while ad valorem taxes are charged as a percentage of value; modern tax systems largely prefer ad valorem and value-added structures.
- As economies develop, tax revenue shifts from land and trade taxes toward income-based and consumption-based systems, with greater reliance on direct taxes in advanced economies.
- India’s GST follows a dual model (CGST, SGST, IGST) with online compliance, simplifying administration and enhancing transparency.
- Compared with the US and UK, India has a centralized income tax system, a multi-slab GST, and effective top rates that can be comparable after surcharges, while differing in federal structure, indirect tax design, and residency rules.
- Tax impact denotes the statutory payer of a tax, whereas tax incidence identifies who ultimately bears the economic burden—crucial for understanding the real effects of taxation on consumers, producers, and income distribution.
- Overall, the unit highlights how tax structure, design, and administration shape efficiency, equity, compliance, and economic integration.

4.11 MODEL QUESTIONS

1. Explain the concept of taxation and classify taxes into direct and indirect taxes.
2. Define and distinguish between specific tax and ad valorem tax.
3. “A sound tax system promotes economic growth” Justify.
4. Explain the tax structure of India and compare it with the tax systems of developed countries like the USA and the UK.

4.12 FURTHER READING

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UNIT 5: BASIC TAX CONCEPTS AND TERMINOLOGY

UNIT STRUCTURE

5.1 Learning Objectives
5.2 Introduction

Basic Concepts of Tax

5.1.1 Person
5.1.2 Assessee
5.1.3 Assessment Year and Previous Year
5.2 Residential Status: Concept and Relevance
5.3 Exemptions and Deductions
5.4 Tax Planning
5.5 Tax Avoidance
5.6 Tax Evasion
5.7 Tax Management
5.8 Let Us Sum Up
5.9 Further Reading
5.10 Answers To Check Your Progress
5.11 Model Questions

1.1 LEARNING OBJECTIVES

After going through this unit, you will able to:

- explain the basic concept of Tax
- define the tax terminologies viz. person, assessee, assessment year, previous year
- illustrate the concept and relevance of residential status
- differentiate between Exemptions and Deductions
- explain the meaning of tax evasion, avoidance tax planning and tax management

1.2 INTRODUCTION

The collections from taxes constitute a major source of revenue for government in order to run the nation. The government generates tax revenue through levy of taxes on income, wealth, manufacturing and trading of goods and services, export and import etc. and utilizes the fund to perform various functions viz. maintenance of law and order; safeguard the security of the country fromforeign aggression, implementation of various programmes for socio-economic development of the nation etc. Only the Government has the authority to levy and collect taxes. The Constitution of India has given the power to both Central and the State Government to level and collect taxes.

Taxation refers to the practice of generating revenue through levy and collection of taxes from the public for incurring public expenditures. Taxation is an age old practice, however, it has passed through different stages with passage of time,and tax's functions and objectives also have changed from the ancientcommunities to medieval societies to modern societies also. Hence the taxationsystem has evolved with the evolution of the functions of the modern state.

In India, taxation has been in force in one form or another from ancient times. We find references of variety of tax measures in both Manu Smriti and Arthasastra. Chanakya has described about the system of tax administration in the Mauryan Empire.

In the present time, taxation is not just a medium of generating revenue for the government to meet the public expenditures, but it has evolved as a tool for redistribution of income and wealth in the society. It also serves as a means of economic development and plays a significant role in stabilization of income. Taxation assists in reducing the economic problems which a country may face, like unemployment, inflation, and depression.

1.3 BASIC CONCEPTS OF TAX

In simplest terms, we can say that tax is nothing but money that the people pay to the Government for providing public services. For levy and collection of taxes, the Government has designed appropriate tax laws. On classification of taxes on the basis of levy, we find two types of taxes- **direct taxes** and **indirect taxes**. Income Tax is a major constituent of Direct Taxes levied and collected by the Government in India. While Goods and Service Tax (GST) constitute as the major source of Indirect Taxes. In order to have a basic understanding of tax, a few important terminologies as defined in the Income Tax laws have been covered in this unit. The Income Tax Act, 1961 has been brought into force with effect from 1st April,1962. It applies to the whole of India and Sikkim (including Jammu and Kashmir).

An income tax is a tax usually levied on the annual income of a person earned during the year. The terms income, income tax, person, financial year etc. has been clearly defined in the Income Tax Act. In this Unit, we shall discuss a few important terms as defined in the Income Tax Act. We shall also discuss the concept and relevance of residential status; exemptions and deductions; tax evasion, avoidance tax planning and tax management.

1.3.1 Person

In the context of income tax the term 'persons' has a special meaning. The meaning of the term 'person' has been incorporated in the Income Tax Act 1961 in Section 2(31). It has first categorised, the term 'persons' in the following way:

(i) An Individual;

(ii) A Hindu Undivided Family (HUF);

(iii) A Company

(iv) A Firm;

(v) An Association of Persons (AOP) or a Body of Individuals (BOI), whether incorporated or not;

(vi) A Local Authority;

(vii) Every Artificial Juridical Person not falling within any of the preceding sub-clauses.

Let us explain these below:

(i) An Individual means a human being. The individual may be a man, woman or a minor child. The income of a minor is included in the income of parent who has higher income after deduction of Rs. 1,500 for each child. The assessment of lunatic or idiot or minor whose income is taxable in his own hands is done in accordance with the provisions of Section 160.

(ii) Hindu Undivided Family (HUF): 'Hindu Undivided Family' has not been defined under the Income-Tax Act and therefore, the definition given under the Hindu Law is accepted under the Income-Tax Act. As per the Hindu law, it means a family which

consists of all persons lineally descended from a common ancestor including their wives and unmarried daughters.

(iii) Company: Section 2(17) defines company in the following way:

a) any Indian company,

b) any body corporate incorporated under the laws of aforeign country,

c) any institution, association or a body which is assessed or was assessable a company ,

d) any institution, association or a body, which is declared by general or special order of the Central Board of Direct Taxes to be company.

(iv) A firm: A firm is a taxable entity separate and distinct from itspartners.

Association of Persons: This term is also not defined in Income Tax Act. In ordinary sense, an association of persons means two or more persons who join for a common purpose with a view to earn an income without forming a partnership firm. They may be assessed as an Association of Persons (AOP).

(v) Body of Individuals (BOI): Body of Individuals means a group of persons who carry on some activity with the objective of earning some income. It shall consist of individuals only. Entities like companies or firms cannot be members of a body of individuals. Income-tax shall not be payable by an assessee in respect of the receipt of share of income by him from BOI and on which the tax has already been paid by such BOI.

(vi) A Local Authority: The term local authority means any authority formed under any law for the local management of any area.They include:

(a) Panchayat as referred to in clause (d) of Article 243 of the Constitution; or

(b) Municipality as referred to in Article 243P of the Constitution; or

(c) Municipal Committee and District Board, legally entitled to, or entrusted by the Government with, the

control or management of a Municipal or local funds;

or

(d) Cantonment Board as defined in Section 3 of the Cantonments Act, 1924.

(vii) Artificial Juridical Persons: Artificial juridical persons are entities which are not natural persons but are separate entities in the eyes of law. Such artificial juridical persons cannot be sued directly in a court of law but they can be sued through persons managing them. For example, Lord Jagannath Madir, Tirupati Mandir etc. Such places of worship have their income from subscriptions, donations, offerings, etc. Such incomes are taxable under the Income Tax Act. However, under the Income Tax Act, they have been provided exemption from payment of tax under separate provisions of the Act, if certain conditionsmentioned therein are satisfied.

In addition to the above, all other artificial persons, with ajuristic personality, if they do not fall within any of the precedingcategories mentioned above will also fall under this categoryof persons. For example; Krishna Kanta Handique State OpenUniversity, Gauhati University, etc.

Income Tax is charged on the income earned by an assessee during the financial year. Section 2(24) of the Income Tax Act, 1961 has defined the term “Income” providing an inclusive list of incomes for the purpose of the Act. Any receipt which comes within the scope of Section 2(24) is considered as income and the receiveris taxed on that amount. Income, in common parlance, means a periodical monetary receipt/ return coming in with some sort of regularity and from definite source. Income tax, as the word itself signifies, is a tax on income. But the Act does not adequately define the term 'income'. Its meaning is more or less similar to the layman's understanding of its being equal to money or money's worth periodically received from a definite source. It may be taken to denote anything which comes in and that too, from some outside source. Income may be received in cash or in kind which is equivalent to

cash. Wherever an assessee earns an income, he/she is taxed on such income.

1.3.2 Assessee

As per Section 2(7) of the Income Tax Act, "Assessee" means a person by whom any tax or any other sum of money is payable under this Act. In addition, it includes –

- Every person in respect of whom any proceeding under this Act has been taken for the assessment of -
  - his income; or
  - the income of any other person in respect of which he is assessable; or
  - the loss sustained by him or by such other person; or
  - the amount of refund due to him or to such other person.
- Every person who is deemed to be an assessee under any provision of this Act;
- Every person who is deemed to be an assessee-in-default under any provision of this Act.
- Every assessee is a 'person', but every 'person' need not be an assessee.

1.3.3 Assessment Year and Previous Year

It is essential to know the meaning of time period for income tax purpose. In India, the Government maintains its accounts for a period of 12 months from 1st April to 31st March every year. This period from 1st April to 31st March each year is known as financial year. The financial year for a non-government entity and non-corporate entity may be a different one.

According to Section 2(9), 'Assessment year" means the period of 12 months commencing on the 1st day of April every year end with 31st March next year.

In so far as income tax is concerned, income earned in a particular financial year (beginning from 1st April of a year and endingon 31st March of the subsequent year) is taxable in the next financialyear.

Previous year is the particular financial year in which the income is earned. It is also known as income year. According to Section 3 of the Income Tax Act, "Previous Year" means the financial year immediately preceding the assessment year. The next financial year in which the said income is taxable is known as the assessment year. It should be noted that the previous year may not always be a period of 12 months. In the case of a business or profession newly set up, or a source of income newly coming into existence, in the said financial year, the previous year shall be the period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly comes into existence and ending with the said financial year

When a person earns income in the previous year (suppose Financial Year 2019-20) the same will be charged to tax in the Assessment Year 2020-21 (i.e. from 01.04.2020 to 31.03.21). The rate at which income is taxable in a particular assessment year will

be the rate as existing on 1st April of that Assessment Year.

1.4 RESIDENTIAL STATUS: CONCEPT AND RELEVANCE

Income Tax is leviable on the taxable income and to determine taxable income, ascertainment of the residential status of the person and scope of total income are initially required. The residential status of an individual is determined on the basis of duration for which he or she is present in India. Based on his or her stay in India an individual is categorized either as (i) resident and ordinarily resident, (ii) resident but not ordinarily resident or (iii) non-resident. Sourced based income in India is taxable in India whether the person earning income is resident or non-resident. Again, foreign sourced income of a person is taxable in India only if such person is resident in India. Therefore, the determination of the residential status of a person is very significant in order to find his or her tax liability. Section 6 of the Income Tax Act describes the conditions for determining the residential status of a person for calculation of tax liability. We shall have a detailed discussion along with examples on calculation of determining the residential status of a person in our successive course.



CHECK YOUR PROGRESS

Q 1: On classification of taxes on the basis of levy, we find two types of taxes- ……..and ……..

Q 2: Define the terms under Income Tax Laws-

a) Person b) Assessee

a) ……

……

1.5 EXEMPTIONS AND DEDUCTIONS

In our previous discussions, we have understood that Income Tax is calculated on the total income of a person for the previous year. From the total income, a person is permitted to claim certain exemptions or avail deductions as tax relief. The term exemptions and deductions are often interchangeably used and confused with one another. However, there are differences between the concepts and both have distinct purposes. In the discussion below, we shall try to understand the concept of exemptions and deductions as stated in the Income Tax Laws and note the differences.

Exemptions: The Government periodically provides relief to the tax payers by permitting to exclude certain incomes from the total income earned during the previous year. Such incomes are categorized as exempted income under the Income Tax Laws. Some of the incomes are fully exempted while some are partially exempted. For Example: Agricultural Income is fully exempted from Income Tax. Exemptions are claimed on the basis of source of Income. All the exempted incomes are defined u/s 10 of the Income Tax

Act. The Exempted incomes are not considered in the calculation of taxable income of the assessee.

Deductions: The Income Tax Law allows deductions to taxpayers to reduce their taxable income, ultimately lowering their overall tax liability. The deductions are allowed on the basis of the payments/investments made. The deductions are allowed under different heads of income as well as from the gross total income.

Exemptions vs Deductions: Both exemptions and deductions provide relief to the tax payers by reducing the tax liability but they differ in application and purpose.

- **Meaning:** Exemptions are exclusion of certain income from the computation of gross total income. While, deductions are reduction allowed generally on the basis of certain payments/investments made.
- **Application:** Exemptions are basically claimed from the specific incomes before calculating the gross total income. On the other hand, a majority of the deductions are availed from the gross total income.
- **Purpose:** Exemptions are provided to give tax relief on certain specified incomes, while deductions are aimed to extent tax relief on the basis of certain expenses\investments made.

Having knowledge and clear understanding of the exemptions and deductions pre-defined under the Income Tax Laws will help us in optimizing our tax relief and improve tax planning.



CHECK YOUR PROGRESS

Q 3: Write two differences between exemptions and deductions.

.....

1.6 TAX PLANNING

As a general view, we all know that activities done with proper planning produces better results. And tax planning is no different. Tax planning is a systematic financial procedure wherein the tax payer would ensure compliance with the taxation provisions in such a manner that full advantage is taken of all tax exemptions, deductions, concessions, rebates and reliefs permissible under the Income Tax Act so that the incidence of tax is the least. The various tax benefits in the form of incentives, concessions, allowances, rebates, reliefs, etc. provided for in the tax laws are meant to be availed for certain clear objectives to achieve. Tax planning may, therefore, be regarded as a method of intelligent application of expert knowledge of planning corporate affairs with a view to securing consciously provided tax benefits on the basis of the national priorities in consonance with the interests of the State and the public. Tax planning is extremely important for new business entities that are to be set up in India and has become extremely important after the increasing market competition and the post-pandemic consequences. Tax planning aims to reduce the outflow of cash resources made available to the Government by way of taxes so that the same may be effectively utilised for the benefit of the individual or the business, as the case may be. Tax planning is legal and can neither be equated to tax evasion nor

to tax avoidance.

In order to have a better understanding of the concept of tax planning, let us discuss about tax avoidance and tax evasion and how tax planning differs from them.

1.7 TAX AVOIDANCE

Tax avoidance is a method of taking advantage of the loopholes in the tax law of the country to avoid paying taxes. It minimizes tax liability using complex and often critical provisions of the Act. Tax avoidance uses legal means to avoid taxes but is not encouraged because it is an exploitationof the legal provision of the tax law which was not intended or considered while framing the law. Suggestions from the tax experts and taxpayers and continuous evaluation of the various provisions of the Income Tax Act may help in the removal of such loopholes and may thus reduce the incidences of tax avoidance.

One can consider their residential status in some safe tax havens where tax rates are low or where special incentives are given for certain activities which are not available in the assessee's own place of residence,in order to avoid paying taxes. In addition, they may also change their business structure or establish an offshore company in tax havens, etc.

Having considered the meaning of each of the above methods of reducing tax liability we may now consider the differences between each one of them.

Tax Avoidance vs. Tax Planning:

(i) Tax planning contributes to the nation building by investing in certain activities which are normally not ventured into. On the other hand, tax avoidance is simply paying less tax or not paying tax at all without anycontribution to the society.

(ii) While tax planning is perfectly legal and encouraged by the government, tax avoidance is somewhat legal but not always encouraged.

(iii) Tax planning is not risky at all while tax avoidance involves a lot of

risk.

(iv) Tax planning is using the exemptions and reliefs specifically provided in the Act which is meant to be used to reduce tax liability but tax avoidance is using the unintended, hidden and often unspecified taxprovisions to reduce tax liability.

1.8 TAX EVASION

Tax Evasion is another method of evading taxes used by assessees. This method is resorted to with the motive of defrauding. Tax is evaded by concealing income, by showing lesser income and other providing false and incomplete information to the taxing authorities. Tax evasion is always done intentionally by maintaining different sets of books of accounts, carrying on transactions in cash with no invoices, carrying on transactions in a dummy name, preparing false invoices, paying lesser taxes than what is being assessed, etc.

Tax evasion may be resorted to with an intention of defrauding. It may also be resorted because of high rates of tax, absence of taxpayer-friendly tax policies and absence of adequate tax incentives. Tax evasion is mostly adopted by people having black money. They conceal their income and as a result evade taxes.

It results in loss of revenue to the state exchequer. It is one of the reasons for the rise in inflation. Tax evasion is considered a civil offence in the country, i.e., illegal and immoral. It is a growing menace in the country as more and more people are stashing money abroad in tax havens and thus avoiding paying of taxes. Assets are kept hidden and undeclared so

that tax can be evaded. This menace can be stopped by having a strict andefficient tax system in the nation so that tax evaders can be easily locatedand can be penalized for such illegal action.

Tax Avoidance vs. Tax Evasion:

1.While in tax avoidance one discloses all material facts, under tax evasion there is often incomplete or false information being disclosedby the assessee.

2.Tax avoidance is reducing of tax liability by using the loopholes in the Act, while tax evasion is evading of taxes by fraudulent means like misrepresenting or concealing information or not paying tax at all.

3.Tax avoidance exploits the tax laws but is not considered illegal always as it works within the ambit of law although it is not intended by the law makers nor encouraged, while tax evasion is definitely illegal as it uses illegal methods to reduce tax liability and evade taxes which the tax payer legally owes.



CHECK YOUR PROGRESS

Q 4: State the meaning of Tax Planning.

1.9 TAX MANAGEMENT

Tax management refers to compliance with the income tax rules and regulations. Tax management covers matters relating to penalties, prosecution, appeal, tax revision or settlement of tax cases. The objectives of tax management are to ensure compliance with tax laws at the specified time and in the specified manner as also to ensure that the tax cost is minimized. The functions of tax management include tax planning, organizing the personnel to ensure tax compliance and directing and coordinating the compliance with all the provisions of tax laws.

The important areas of tax management include:

1. Tax Deducted at Source
2. Collection of tax at source: In some special cases, some persons responsible for collecting the tax at source from the buyers
3. Payment of advance tax
4. Maintenance of Books of Accounts: Maintaining books of accounts and other relevant documents so that the tax can be computed accurately and verified by the Assessing Officer. Maintenance of account books, vouchers, bills, correspondence and agreements, etc. is a part of tax management.
5. Audit of books of accounts: If the turnover of the business for the previous year 2015-16 exceeds one crore rupees, the audit of books of accounts is compulsory as per income tax rules.
6. Furnishing the return of income: The tax manager must ensure that the return of income is furnished on time otherwise the assesse will lose the right to carry forward and set off the losses and become

liable to pay interest, penalty, prosecution or fine or both.

7. Documentation and maintenance of tax records: An assessee should keep complete and updated tax files so that the documentary evidences can be made available in case of all queries. Tax files include filed returns, Form 16, documentary evidence in support of deductions, rebate and relief, court orders, etc.
8. Review of orders of Income Tax Department: Review the assessment orders and other orders received from the tax department is an important function of tax management. If there is any mistake in the order, application for rectification can be made. If the order is prejudicial to the interest of the assessee he can file an appeal, revision or an application for settlement of case can be made.



1.10 LET US SUM UP

In this unit we have discussed the following:

- Taxation refers to the practice of generating revenue through levy and collection of taxes from the public for incurring public expenditures.
- In the present time, taxation is not just a medium of generating revenue for the government to meet the public expenditures, but it has evolved as a tool for redistribution of income and wealth in the society. It also serves as a means of economic development and plays a significant role in stabilization of income.
- An income tax is a tax usually levied on the annual income of a person earned during the year. The terms income, income tax, person, financial year etc. has been clearly defined in the Income Tax Act.

- The residential status of an individual is determined on the basis of duration for which he or she is present in India. Based on his or her stay in India an individual is categorized either as (i) resident and ordinarily resident, (ii) resident but not ordinarily resident or (iii) non-resident.
- Both exemptions and deductions provide relief to the tax payers by reducing the tax liability but they differ in application and purpose
- Tax planning is a systematic financial procedure wherein the tax payer would ensure compliance with the taxation provisions in such a manner that full advantage is taken of all tax exemptions, deductions, concessions, rebates and reliefs permissible under the Income Tax Act so that the incidence of tax is the least.

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1.11 FURTHER READING

1.12 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1:

Ans to Q No 2:

Ans to Q No 3:

Ans to Q No 4:

1.13 MODEL QUESTIONS

Q 1: Define Assessment Year and Previous Year under the Income Tax Act, 1961.

Q 2: Discuss the concept and relevance of Residential Status.

Q 3: Differentiate between exemptions and deductions.

Q 4: Differentiate between tax planning and tax management.

Q 5: Write a short note on tax management.

Q 6: Write short notes on:

a) Tax Avoidance

b) Tax Evasion

c) Assessment Year

d) Tax Panning

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Q 9: Ascertain the period of previous year and assessment year in thefollowing cases:

(i) Ajay has been running a business from 2020. State the previous year for the assessment year 2022-23.

(ii) Ashok started a business on 1st May 2021. Determine the previous year for the assessment year 2022-23.

Q 10: Give four examples of "Exempted Incomes".

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UNIT 6: FUNDAMENTAL PRINCIPLES OF TAXATION

UNIT STRUCTURE

8.1 Learning Objectives

8.2 Introduction

8.3 Concept of Equity in Taxation

8.5 The benefit Principle of Taxation

8.5 The Principle of ability to Pay

8.6 Rate Schedules of Taxation

8.7 Let Us Sum Up

8.8 Further Readings

8.9 Answer to Check Your Progress

8.10Model Questions

6.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- discuss the concept of equity in taxation
- explain the benefit principle of taxation
- appreciate the ability to pay approach to taxation
- explain the rate schedules of taxation

6.2 INTRODUCTION

Tax Revenue is the most important source of revenue receipt of the state. While mobilising tax revenue, the burden of taxation has to be distributed among the tax-payers. Principles of

taxation provides the theoretical basis on which a tax system is structured. They determine how the burden of taxation will be allocated among the citizens and justify the basis of such allocations.

6.3 COCEPT OF EQUITY IN TAXATION

It is universally agreed that a taxation system should be equitable. Here the concept of equity in taxation is associated with the idea of fairness and justice, with regards to how the burden of taxation should be allocated among the tax payers. The equity principle is the most important principle of taxation. It has two basic implications: Horizontal Equity: “Like people should be treated in a like manner”. This implies people in similar circumstances should be taxed equally. Vertical Equity: “Unlike people should be taxed in an unlike manner”. The implication is that people in different circumstances should be treated unequally. However over the years there had been no agreement regarding an universally acceptable definition of equity. Besides, taxation principles have found it difficult to specify how equally should unequals be taxed. Again, in attempting to satisfy the demands of attaining vertical and horizontal equity the domain of taxation theory has evolved on the basis of two broad approaches: The Benefit Principle of Taxation, and The Ability-to-Pay Approach.

6.3.1 The Benefit Principle of Taxation

The benefit principle of taxation considers tax as a price paid for the benefit received from the state. Thus, it considers the relationship between the tax payers and the state, as one of exchange, based on the principle of ‘quid-pro-quo’. The implications of the benefit principle are as follows Just like market transactions tax payment is made only against benefit received in form of goods and services from the government. The amount of tax paid by an individual must equal the marginal benefit that he receives from the public good and service. The total provision of public goods must equal its total demand. Besides the total cost of provision of public goods must be covered by the total tax revenue mobilised. The benefit principle can be interpreted on the criteria of: Cost of service, and Value of service Under the cost of service criterion, the tax contribution by an individual must cover the cost of provision of the public goods that he consumes. On the other hand, the ‘value of service’ criterion, is applicable when the cost of the public good provided cannot be determined. Here the contribution of the tax payer is determined on the basis of the worth or value of the public good to him. The benefit principle has found wide

support on grounds of equity and justice. This is because taxation here, is justified with the argument that it is imposed policy against benefit extended by state provision of goods and services. Although the benefit principle of taxation dates back to the writings of Adam Smith, however modern version of this principle is most suitably articulated by Erick Lindahl in his Voluntary Exchange Model. The benefit principle is widely acknowledged as it is consistent with principles of equity and justice. The rationale that people should be taxed in accordance with the benefit that they receive found universal acceptance. However, the concept of taxation rejects the premises of this principle, as tax is considered to be a mandatory contribution which has no 'quid-pro-quo' connotation. Besides benefit is a subjective concept, which cannot be specifically measured. Hence operationally it is impossible to equate tax paid to the benefits received from public provision

6.3.2 The Principle of Ability to Pay

A tax is defined as a compulsory payment without any 'quid-pro-quo' relationship between the tax payer and the state. Hence in keeping with this definition the benefit principle fails to satisfy the basic spirit of taxation. The "Ability-to-Pay" Approach to taxation is based on the principle that people should be taxed in accordance with their ability to pay. Thus taxation imposed on the Ability-to-Pay principle would ensure that people with more income and wealth are more heavily taxed than people whose income and wealth are relatively less, so that every tax payer ends up making equal sacrifice (or bearing the same burden). Thus, in the words of Dalton, "Ability-to-pay principle requires that the burden of taxation should be so distributed that the directed real burden on all tax-payers is equal". In the ability-to-pay principle of taxation, ability has been measured by — Subjective Approach, and Objective Approach The Subjective Approach : In the subjective approach to the ability-to-pay principle, the tax burden is interpreted in terms of the sacrifice undergone by the tax payer. Thus here, it is assumed that the ability-to-pay principle would be satisfied by an allocation of tax burden which would ensure that all tax-payers make equal sacrifice, when they pay their individual tax amount. Given the fact that income is subject to the law of diminishing utility, an application of the equal sacrifice rule on the tax payers would imply that richer people are taxed more heavily, than people who have relatively lesser income and wealth. In fact, there are three distinct interpretations of equal sacrifice principle. Equal Absolute Sacrifice, Equal Proportional Sacrifice, and Equal Marginal Sacrifice. Equal absolute sacrifice implies that the total loss of utility or sacrifice should be equal

for all the tax-payers irrespctive the income groups they belong to. Thus, according to this principle, persons belonging to higher income group should pay higher taxes compared to a person belonging to a lower income group. This principle was very popular among economists, however, later it has been criticised; as this principle endorses regressive taxation. The priniple of equal proportional sacrifice on the other hand propagates that loss of utility as a result of tax payment should be proportional to the total income of the tax-payers. Thus, according to this principle, the higher income group should pay higher taxes compared to the lower income group; however their ratio of tax payment to their total income will be the same. The principle of equal marginal sacrifice is also known as 'Principle of Least Aggregate Sacrifice'. Economists point out that this principle is superior to others. This principle is equitable, as well as it has been derived from the basic utilatarian principle of maximum happiness. This principle argues that the object of the state is to maximise the economic welfare. Again it is a general fact that tax payment creates disutility to the taxpayers. That is why taxes should be distributed in accordance with the principle of least aggregate sacrifice, i.e., the marginal sacrifice imposed by taxation on each taxpayer should be equal. This will minimise the agrregate sacrifice of the community; at the same this will lead to maximum welfare to all the taxpayers in the community. Given the differences in the definition among the three interpretations, different tax rate schedules are required to satisfy these three rules of equal sacrifice. The Objective Approach: In contrast to the subjective approach, the objective approach considers income and wealth to be the basis of ability to pay of the tax payers. There are three important indices of ability to pay in this approach. Income: In a modern economy, income is universally accepted as an index of ability-to-pay of a tax payer. Thus, accordingly individuals with greater income are taxed more heavily than individuals whose incomes are relatively lower. Wealth: Earlier wealth (or property) was considered to be the more important index of ability-to-pay of a tax payer. It was argued that people with more wealth were capable of paying more tax. However, it was realised that people with large income but no wealth (or property) might avoid taxation, if wealth was the sole criterion for taxation. In contemporary economics wealth is used only as a supplement to income in assessing the taxable capacity of an individual. Consumption Expenditure: Many prominent economists have suggested that consumption expenditure truly reflects the ability-to-pay of a tax-payer. This index is also supported because it does not act as an dis-incentive to work, save and invest. However, this index is dis-favoured on the ground of equity as a person with more dependents would be severely penalised if he is taxed on the basis of his consumption expenditure To conclude, there has been a universal acceptance of the ability-to-pay principle of taxation as a basis for the allocation of tax burden. This is because, it satisfies

the ideals of horizontal and vertical equity and secures social justice for the people. However, this approach suffers from the fact that there is no unanimous definition or criterion of ability to pay. In the subjective approach, equal sacrifice as a criterion of ability is difficult to measure or to define. Similarity, in the objective approach there is difference of opinion with regards to which index to adopt to measure ability.

CHECK YOUR PROGRESS

Q1: State whether the following statements are True(T) or False(F):

(a) Benefit Principle considers tax to be a "quid-pro-quo" transaction. (True/False)

(b) Ability-to-pay Approach considers wealth to be the only basis for taxation (True/False)

Q2: Mention the three interpretations of equal sacrifice principle. (Answer in about 30 words)

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6.4 RATE SCHEDULES OF TAXATION

A taxation system can have three distinct tax rate schedules. They are:

Proportional Taxation: Under proportional taxation, all tax payers are taxed at the same rate, whatever be their income. Thus here, each tax payer pays a fixed proportion of his income as tax. In proportional taxation, taxes vary in direct proportion to change in income. This implies that, whatever be the base, the ratio between the tax liability and the tax base always remains constant. Thus, for example, if the income of a person (i.e. tax base) increases from Rs. 10,000 to Rs. 20,000, he will continue to be taxed at the same rate, i.e. 10%. This implies, his tax liability will double from Rs. 1000 to Rs. 2000, with a doubling of his tax base. The system of proportional taxation has been favoured on grounds of equity (as the tax liability is proportional to the tax payer's income) and neutrality (as it does not disturb the distribution of income). Besides proportional taxation is more convenient to administer as everyone is taxed at the same rate. However, this system has been criticised on the grounds that it violates the principle of

equity as the real burden of tax is more heavy on the poorer people who are taxed at the same rate, as are the rich.

Progressive Taxation : Under progressive taxation, the tax liability increases more than in proportion to increase in the tax base. Here the ratio of tax liability to tax base increases, as the tax base expands. In a progressive taxation system, bigger the income higher will be the tax rates. Thus for example, if a individual with an income of Rs. 1000 is taxed at 5%, then individuals with bigger incomes like Rs. 2000 and Rs. 3000, will be taxed a higher rates of 7% and 10% respectively. Progressive taxation is promoted on the ground that since the marginal utility of money for a rich person is smaller than that of a poor person, equity requires the richer person to be taxed at a higher rate than a poor person Again it is generally agreed that productive capacity and consumption increases faster than increase in income and wealth. Hence it is only just that richer people should be taxed at a high rate than relatively poorer people.

Regressive Taxation : In regressive taxation, the rate of tax decreases as the tax base expands. Thus, under this system, the ratio of tax liability to tax base decreases with an increase in the tax base. Thus, in a regressive tax schedule, a richer person will be taxed at a lower rate whereas a poorer person will be taxed at a higher rate. For example, a tax schedule will be regressive if a person with income of Rs. 10000 is taxed at 5% whereas a person with a smaller income of Rs. 5000 is taxed at 10%. As is obvious, regressive taxation is inequitable and unjust, because it imposes the greatest burden of taxation on the poorest in the society. Besides being unjustifiable from the ethical point of view, it also is socially unacceptable as it accentuates inequalities in income and wealth in the society

CHECK YOUR PROGRESS

Q3: State whether the following statements are True (T) or False (F) :

(a) Under proportional taxation, tax rates increase with the expansion of tax base. (True/False)

(b) Progressive taxation does not satisfy the principle of equity. (True/ False)

Q4: Distinguish between regressive taxation and progressive taxation. (Answer in about 60 words) .....
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6.5LET US SUM UP

Principles of taxation determine how the tax burden in the economy is to be allocated. The concept of equity in taxation calls for horizontal and vertical equity. The benefit principle considers tax as the price paid against benefits received from the state. The 'ability to pay' approach states that people should be taxed in accordance with their ability to pay. In a modern economy, income is accepted as the most ideal index of ability to pay. A taxation system has three distinct tax rate schedules Proportional Taxation Progressive Taxation Regressive Taxation

6.6 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1:

(a) True

(b) False Ans to

Q No 2: The three interpretations of equal sacrifice principle are: Equal Absolute Sacrifice, Equal Proportional Sacrifice, and Equal Marginal Sacrifice.

Ans to Q No 3: (a) False (b) False

Ans to Q No 4: In the system of progressive taxation, higher the income higher will be the tax rates. But contrary to this, in the system of regressive taxation, the rate of tax decreases as the tax base expands. Progressive taxation is promoted on the ground that since the marginal utility of money for a rich person is smaller than that of a poor person, equity requires the richer person to be taxed at a higher rate than a poor person. Contrary to this, regressive taxation is inequitable and unjust, because it imposes the greatest burden of taxation on the poorest in the society. It is also criticised as unjustifiable from the ethical point of view Regressive taxatin is also socially unacceptable as it accentuates inequalities in income and wealth in the society.

6.7 FURTHER READING

1) Bhatia, H. L. (2006). Public Finance. New Delhi : Vikas Publishing House Pvt. Ltd.

2) Lekhi, R. K. (2006). Public Finance and Fiscal Policy. Ludhiana : Kalyani Publishers.

3) Menkar and Sarma (2001). Public Finance : Theory and Practice. Mumbai : Himalaya Publishing House.

4) Prakash, O (2008). Public Economics : Theory and Practice. Jalandhar: Vishal Publishing Co

MODEL QUESTIONS

Short questions (Answer each question in about 150 words)

Q 1: Explain the concept of equity in taxation.

Q 2: State one merit and one demerit of the benefit principle.

Q 3: Why is income considered to be a better indicator of 'ability-to pay' than wealth or consumption expenditure?

Essay-type questions (Answer each question in about 300-500 words)

Q 1: Explain the three tax-rate schedules. Examine their merits and demerits.

Q 2: Compare the benefit principle of taxation with the ability to pay approach. Which one is superior operationally?

UNIT 7: TAXATION PROCEDURE AND COMPLIANCE FRAMEWORK

UNIT STRUCTURE

7.1 Learning Objectives

7.2 Introduction

7.3 Overview of Tax Return Filing Systems

- 7.3.1 Income Tax Return Filing
- 7.3.2 Goods and Services Tax Returns
- 7.3.3 Other Returns

7.4 PAN, TAN And Aadhaar Linkages

- 7.4.1 Permanent Account Number (PAN)
- 7.4.2 Tax Deduction and Collection Account Number (TAN)
- 7.4.3 Aadhaar Linkages

7.5 Overview of Assessments: Summary, Scrutiny and Best Judgment

- 7.5.1 Summary Assessment
- 7.5.2 Scrutiny Assessment
- 7.5.3 Best Judgment Assessment

7.6 Advance Tax: Concept

7.7 Tax Audit: Concept

7.8 Compliance Calendar for Business Firms

7.9 Let Us Sum Up

7.10 Further Reading

7.11 Answers to Check Your Progress

7.12 Model Questions

7.1 LEARNING OBJECTIVES

After studying this unit, the learner will be able to:

- Explain the basic process of filing income tax and other tax returns in India, without going into the heads of income.

- Describe the purpose of PAN, TAN and Aadhaar in the tax system and why linkages are used.
- Understand, at a basic level, what summary assessment, scrutiny assessment and best judgment assessment mean.
- Explain the idea of advance tax and when it becomes relevant for a taxpayer.
- Understand the concept of tax audit in simple terms and why it is important.
- Outline a simple compliance calendar for a typical business firm, covering key tax related due dates.

7.2 INTRODUCTION

Tax law does not stop at defining who should pay tax and how much they should pay. Every tax system also needs clear procedures so that taxpayers know what to do, when to do it and how to show that they have followed the law. These procedures include obtaining identification numbers, filing returns in the correct form, paying tax at the right time and responding to any questions that the tax department may ask.

In India, over the last two decades, tax procedure has moved rapidly from paper-based methods to online systems. Income tax returns are now filed electronically for most taxpayers. Goods and Services Tax returns for businesses are also filed on a common portal. Taxpayers use permanent identification numbers, such as PAN and TAN, and in many cases Aadhaar, to link their personal information, income details and tax payments. At the same time, the law gives the tax department powers to check returns through different kinds of assessments, and in some cases to estimate income when proper records are not available.

This unit gives an overview of these procedures and tools. It does not go into the details of how to compute income under different heads. Instead, it focuses on the framework within which taxpayers and the administration interact. Understanding this framework helps students and future practitioners know what is expected of a compliant taxpayer and how to plan business systems so that tax obligations are met in time and with minimum difficulty.

7.3 OVERVIEW OF TAX RETURN FILING SYSTEMS

In simple words, a tax return is a form in which a taxpayer declares their income, certain financial details and the amount of tax that should be paid or has been paid. Filing a return is the main way a taxpayer reports to the government that they have complied with tax law for a period, usually a financial year.

7.3.1 Income Tax Return Filing

For income tax, individuals, firms, companies and other entities file different types of returns, called ITR forms. Which form applies depends on the nature of the taxpayer, the type of income and certain thresholds. The process follows some common steps:

1. The taxpayer collects all relevant information for the year, such as salary statements, bank interest details, records of business receipts and expenses, details of tax deducted at source (TDS) and advance tax paid.
2. Using this information, the taxpayer or their consultant calculates total income and tax liability. While this involves the heads of income, our focus here is only that the calculation must be done before return filing.
3. The taxpayer logs into the e filing portal of the income tax department using their user ID and password linked to PAN.
4. The correct ITR form is selected, filled in and either submitted online or uploaded after preparation using an off line utility.
5. The return is verified using an electronic method such as Aadhaar OTP, net banking, pre-registered bank account or by sending a signed physical verification form, depending on allowed options.

Two broad concepts are important here. First, there is a due date by which the return should be filed. This date can differ for individuals, firms and companies, and it is sometimes extended by government notification. Filing after the due date can lead to late fees, interest and, in some cases, loss of certain benefits. Second, even if the tax was fully paid through TDS or advance tax, filing a return may still be compulsory if income crosses certain levels or if certain conditions are met.

The online system has some advantages. It reduces physical contact, allows faster processing and gives the taxpayer a record in their account of returns filed, notices received and refunds issued. It also allows

the department to pre fill parts of the return with information it already has, such as TDS details, which reduces errors if the taxpayer checks and confirms these entries carefully.

The **Finance Bill 2026** and some past acts explain of Income Tax Return (ITR) and define as below:

What is Income Tax Return (ITR) Filing?

An Income Tax Return (ITR) is a form that a person (individual, company, or firm) submits to the Income Tax Department of India. It contains details about their income earned during a financial year and the taxes to be paid on it. Filing an ITR is the process of reporting your earnings to the government.

Who Must File an ITR?

According to the tax laws, the following people must file an ITR:

1. **Companies and Firms:** Every company and partnership firm must file a return, regardless of whether they made a profit or a loss.

2. **Individuals exceeding the limit:** Any individual whose total income exceeds the "Basic Exemption Limit" (e.g., ₹3 Lakh, ₹4 Lakh, or ₹5 Lakh depending on the tax regime and age) must file a return.

3. **Specific High Spenders (Even if income is low):** You must file a return if you meet certain spending criteria, even if your income is below the taxable limit:

   ◦ Deposited more than **₹1 Crore** in a current account.

   ◦ Spent more than **₹2 Lakh** on foreign travel.

   ◦ Paid an electricity bill of more than **₹1 Lakh**.

   ◦ Total sales (turnover) in business exceed **₹60 Lakh**.

   ◦ Professional receipts exceed **₹10 Lakh**.

   ◦ Total TDS/TCS deducted is more than **₹25,000** (or ₹50,000 for senior citizens),.

Types of Income Tax Returns

There are different types of returns based on when and why you are filing:

• **Original Return:** The return filed voluntarily on or before the due date.

• **Belated Return:** If you miss the deadline, you can file a late return. As per the new Budget 2026 proposals, this must be filed by **31st December** of the assessment year.

• **Revised Return:** If you discover a mistake or error after filing, you can file a revised return. The **Finance Bill 2026** proposes extending the time limit to file this up to **12 months** from the end of the relevant tax year.

• **Updated Return (ITR-U):** If you missed reporting income, you can file an updated return within 24 months from the end of the assessment year by paying additional tax. The 2026 Bill proposes allowing updated returns even to reduce losses in specific cases.

ITR Forms (Which Form to Choose?)

The government provides different forms based on your income source:

• **ITR-1 (Sahaj):** For resident individuals with income up to ₹50 Lakh from salary, one house property, and other sources (like interest),.

• **ITR-2:** For individuals/HUFs who do not have business income but have capital gains, foreign income, or income above ₹50 Lakh.

• **ITR-3:** For individuals/HUFs having income from a business or profession.

• **ITR-4 (Sugam):** For those opting for "Presumptive Taxation" (small businesses/professionals declaring income as a fixed percentage of turnover).

• **ITR-5 & ITR-6:** For Firms, LLPs, and Companies.

Important Due Dates (Proposed in Budget 2026)

The Finance Bill 2026 proposes rationalizing the due dates for filing returns:

• **July 31:** For salaried individuals and small taxpayers (whose accounts are not audited).

• **August 31 (New Proposal):** For partners of firms and businessmen whose accounts are **not** required to be audited (extended from July 31).

• **October 31:** For companies and taxpayers requiring a tax audit.

• **November 30:** For taxpayers involved in international transactions (Transfer Pricing).

Process of ITR Filing

Here is the step-by-step process for filing your Income Tax Return electronically (E-Filing).

Steps	Action Name	What You Need to Do
Step 1	**Registration**	Go to the Income Tax e-filing portal. If you are a new user, register yourself using your **PAN** (Permanent Account Number).
Step 2	**Log In**	Log in to the portal using your User ID (usually your PAN), Password, and Captcha code.
Step 3	**Download/Select Form**	You can either download the Excel/Java utility to fill offline or choose to file online. Select the correct **ITR Form** (e.g., ITR-1 or ITR-4) and the **Assessment Year**.
Step 4	**Fill Details**	Enter details of your income (Salary, House Property, Capital Gains), deductions (like 80C, 80D), and tax paid (TDS/Advance Tax). The system often pre-fills data from your Form 16 and Annual Information Statement (AIS).
Step 5	**Compute Tax**	The system will calculate if you owe any tax or if you are eligible for a refund. If tax is due, you must pay it before submitting.
Step 6	**Verification**	After submitting the form, you **must verify** it. You can do this digitally using an Aadhaar OTP, Net Banking, or Digital Signature. If you cannot do it online, you must send a signed physical copy (ITR-V) to the Central Processing Center (CPC) in Bengaluru.
Step 7	**Confirmation**	Once verified, the Income Tax Department will process your return and send you an intimation (notice) via email confirming that the process is complete.

Penalty for Late Filing

If you fail to file by the due date, you may have to pay a late fee (fee for default).

- **₹1,000:** If total income is up to ₹5 Lakh.

• **₹5,000:** If total income is more than ₹5 Lakh.

7.3.2 Goods and Services Tax Returns

Most businesses that are registered under the Goods and Services Tax regime must file periodic GST returns. These returns report outward supplies (sales), inward supplies (purchases), input tax credit claimed and output tax payable. The actual list of forms and due dates can be complex and has also changed over time, but some general ideas are useful to remember.

There is usually a monthly or quarterly summary of outward supplies in which a registered supplier declares the value of supplies made and the tax charged. There is also a return that summarises the net tax payable after adjusting input tax credit, and an annual return that gives a year wide picture. Special returns apply to composition taxpayers, non-resident taxpayers and those who collect tax at source or deduct it under GST, but the core idea remains the same: businesses regularly inform the government of their taxable activities and tax calculations.

Like income tax returns, GST returns are filed online through a dedicated portal. Many small firms use software or the services of a tax practitioner to prepare these returns. Timely and accurate filing is very important because it is closely linked to the input tax credit of buyers. If a seller does not report a supply correctly, the buyer may face difficulty in claiming credit for the tax paid. For this reason, GST return filing is not only a legal duty but also part of maintaining good business relationships.

The **Budget 2026** has introduced specific legislative changes that impact how liability is calculated and reported in these returns, particularly regarding discounts and refunds.

Feature	Details	Explanation
Basic Concept	**Self-Assessment**	The taxpayer calculates their own tax liability based on their sales and purchases and reports it to the government.
Tax Components	**CGST, SGST, IGST**	Depending on whether the sale is within the state (Intra-State) or between states (Inter-State), the return must segregate the tax into Central, State, or Integrated GST.

Credit Notes (New Change)	**Section 34 Amendment**	**Major 2026 Update:** Previously, to claim a tax reduction for post-sale discounts, a prior written agreement was needed. The new amendment allows businesses to issue **Credit Notes** for discounts without a strict link to a prior agreement, provided the buyer reverses the tax credit.
Input Tax Credit (ITC)	**Section 15 & 16**	Businesses can claim credit for tax paid on purchases. However, under the new rules, if a supplier issues a Credit Note for a discount, the recipient *must* reverse (reduce) their ITC in their return.
Refunds (New Change)	**Section 54 Amendment**	**Provisional Refunds:** The facility to get a provisional refund (up to 90% of the claim) is now extended to cases of "Inverted Duty Structure" (where tax on raw materials is higher than tax on the final product). This helps businesses get cash back faster.
Export Refunds	**No Threshold**	For goods exported out of India with payment of tax, the minimum threshold of ₹1,000 for claiming a refund has been removed. This helps small exporters claim even small amounts.
Disputes/Appeals	**Section 101A**	If there is confusion regarding a return or classification, the government is empowering an "existing Authority" or Tribunal to hear appeals until the National Appellate Authority is fully set up.

Process of Filing GST Returns (Updated for 2026)

The process of filing returns involves reporting transactions and ensuring that the tax liability matches the government's records. Based on the **Finance Bill 2026** and **ELP Analysis**, here is the simplified process:

Step 1: Recording Invoices and Supplies: The business must maintain a record of all sales. Under the new **Section 34** amendment, if a business gives a discount *after* the sale is made, they can issue a **Credit Note**. They no longer need to prove a pre-existing agreement for every specific invoice to adjust this in their return.

Step 2: Reversal of Input Tax Credit (The Buyer's Duty): When filing the return, if a buyer has received a discount (via Credit Note) from a seller, the buyer must **reduce (reverse)** the Input Tax Credit they had previously claimed on that purchase. This ensures the government does not lose revenue on the discounted portion.

Step 3: Calculating Net Tax Liability: The taxpayer calculates the total tax collected on sales (Output Tax) and subtracts the tax paid on purchases (Input Tax Credit).

• *Calculation:* Output Tax – (Input Tax Credit – Reversals from Credit Notes).

Step 4: Claiming Refunds (If Applicable): If the business has an **Inverted Duty Structure** (buying raw materials at high tax rates and selling finished goods at lower rates), they can now file for a **provisional refund** in their return process. This allows them to get a portion of their money back quickly without waiting for the final assessment.

Step 5: Electronic Filing: The return is filed electronically on the GST portal. The **Finance Bill 2026** emphasizes "Digital governance" and "Unified systems," ensuring that these filings are processed with minimal manual intervention.

Step 6: Assessment and Scrutiny: Once filed, the return is processed. If there are discrepancies (e.g., the supplier declared a sale but the buyer did not reverse the credit for a discount), the new **Section 101A** provisions allow for appeals to a designated authority if disputes arise regarding the tax liability.

7.3.3 Other Returns

Apart from income tax and GST, businesses may need to file returns for tax deducted at source and for tax collected at source. These returns list the payments on which tax was deducted or collected, the amount, and the details of the deductees or collectees. Correct filing ensures that the tax deducted appears in the records of the person from whose income it was deducted, so that they can claim credit when they file their own return.

Overall, the return filing system is the backbone of tax compliance. It creates a regular routine in which taxpayers share information, correct mistakes if needed, and settle any outstanding tax or refunds.

Types of Other Tax Returns

Name of Return	Explanation	Time Limit / New Rules (2026)
1. Belated Return	If you miss the original deadline (usually July 31st or October 31st), you can file a **"Late Return"**.	You must file this before **31st December** of the assessment year or before the assessment is completed by the officer, whichever is earlier.
2. Revised Return	If you discover a mistake, error, or omission in your original return, you can file a **"Corrected Return"** to fix it.	**New Rule:** The time limit has been increased. You can now file this within **12 months** from the end of the relevant tax year (extended from the old 9-month rule).
3. Updated Return (ITR-U)	If you missed reporting income or want to update details after the time for Belated/Revised returns has passed.	Can be filed within **24 months** from the end of the relevant assessment year. **New Rule:** You can now file this even to **reduce a loss** in specific cases (earlier it was mostly for paying extra tax).
4. Return of Loss	If you have suffered a loss in your business or capital gains and want to carry it forward to set off against future profits.	You **must** file this return on or before the due date. If filed late (Belated), you generally **cannot** carry forward the loss (except for House Property loss or Unabsorbed Depreciation).
5. Modified Return	This is a special return filed when a taxpayer signs an **Advance Pricing Agreement (APA)** with the government regarding international transaction pricing.	If an agreement is signed that changes your past income, you must file this modified return within **3 months** from the end of the month the agreement was signed.
6. TDS/TCS Statements	These are quarterly reports filed by a person who has deducted tax (TDS) or collected tax (TCS) from others.	These must be filed quarterly. If you fail to file these statements, a fee of **₹200 per day** applies (up to the total tax amount).

Key Penalties & Fees for "Other Returns"

Type of Default	Fee/Penalty	Simple Explanation
Late Filing Fee	**₹1,000 to ₹5,000**	If you file a Belated Return or Revised Return after the due date, you may have to pay a fee. It is ₹1,000 for income up to ₹5 Lakh, and ₹5,000 for income above that.
Additional Tax (Updated Return)	**25% or 50% extra**	If you file an **Updated Return**, you must pay the tax due plus an **additional tax** of 25% (if filed within 12 months) or 50% (if filed within 24 months) of the aggregate tax and interest.
Reassessment Surcharge	**10% extra**	**New Rule:** If you file an updated return after receiving a reassessment notice, the additional tax increases by a further **10%**.

7.4 PAN, TAN AND AADHAAR LINKAGES

Identification numbers and linkages help the tax system match income, payments and returns across different sources. In India three identifiers are important in this context: PAN, TAN and Aadhaar.

7.4.1 Permanent Account Number (PAN)

PAN is a ten-character alphanumeric code issued by the income tax department to individuals, firms, companies and other entities. It serves as the main tax identity. Once allotted, it generally remains the same for life and should be used in all interactions with the direct tax system.

PAN is required for:

- Filing income tax returns.
- Opening certain types of bank accounts.
- High value financial transactions such as purchase of property, big deposits, and investments beyond specific limits.
- Deduction and payment of certain taxes.

Because PAN is quoted in many financial documents, it allows the department to compile a wider picture of a taxpayer's financial activity. For example, if someone files a return showing very low income but has high value transactions linked to their PAN, this difference may lead to further enquiry.

The **Finance Bill 2026** and the **ELP Union Budget Analysis**, below is a detailed overview of the provisions and amendments related to the **Permanent Account Number (PAN):**

Permanent Account Number (PAN) Provisions (2026)

Aspect	**Details**	**Explanation**
Legislative Reference	**Section 262** of the *Income-tax Act, 2025* covers the provisions related to PAN.	This section grants the Central Board of Direct Taxes (CBDT) the power to make rules regarding where and when a PAN must be quoted.
The Amendment (2026)	**Section 262(10)(c)** is proposed to be amended. The words **"pertaining to business or profession"** are being substituted with **"pertaining to, business or profession, or other transactions"**.	Previously, the government could only demand PAN for business-related documents. The new rule allows them to ask for PAN in **"other transactions"** as well, even if they are not related to business or profession.
Objective of Change	**Expansion of Scope**	This gives the tax department wider powers to track financial transactions. It aligns the new Act with the broader framework of the old Act, allowing the CBDT to mandate PAN reporting for a wider variety of financial activities.
Usage in Property Purchase	**Substitution for TAN**	As per the amendment to **Section 397(1)(c)**, a resident individual or HUF buying property from a **Non-Resident (NRI)** no longer needs a Tax Deduction Account Number (TAN). They can simply quote their **PAN** to deduct tax and pay it via a PAN-based challan.

Effective Date	**1st April 2026**	The expansion of rule-making power under Section 262 comes into effect from **April 1, 2026**. (Note: The property purchase relaxation applies from **October 1, 2026**).

Key Changes in Budget 2026

The 2026 Budget strengthens the role of PAN in two ways:

1. **Broadening Reach:** It allows the government to mandate the quoting of PAN for non-business transactions (like high-value personal purchases or investments) by amending **Section 262**.

2. **Simplifying Compliance:** It replaces the need for a separate **TAN** with **PAN** for residents buying property from NRIs, making the process easier for individual buyers.

7.4.2 Tax Deduction and Collection Account Number (TAN)

TAN is a ten-character alphanumeric code that is required by entities that deduct tax at source or collect tax at source under the income tax law. While PAN identifies the taxpayer in general, TAN identifies the deductor or collector in their capacity as a person responsible for deducting or collecting tax.

A business that pays salaries, interest, contractual fees or rent of certain values may have to deduct tax at source. To do this properly, it must obtain TAN, quote it in all TDS related documents, deposit the tax with the government and file TDS returns. TAN helps the department track whether deductors have fulfilled these obligations and whether the deducted tax has been correctly credited to the accounts of payees.

The **Finance Bill 2026**, the **2026 Budget Analysis**, following is the overview of the provisions regarding the Tax Deduction and Collection Account Number (TAN), highlighting the significant amendments proposed for 2026.

Tax Deduction and Collection Account Number (TAN) Provisions (2026)

Aspect	**Details**

General Requirement	Under **Section 397(1)(a)** of the *Income-tax Act, 2025*, every person deducting or collecting tax is generally required to apply to the Assessing Officer for the allotment of a TAN.
The Amendment (Budget 2026)	The Budget proposes to **remove** the requirement of obtaining a TAN for a specific category of taxpayers: **Resident Individuals** or **Hindu Undivided Families (HUFs)**.
Specific Transaction	This relaxation applies specifically to transactions where a resident Individual or HUF deducts tax on the **purchase of immovable property** from a **Non-Resident** seller (under Section 393(2).
Previous Position	Previously, a buyer was not required to obtain a TAN when purchasing from a *resident* seller. However, if the seller was a *non-resident*, the buyer was required to obtain a TAN even for a one-time transaction.
New Compliance Mechanism	Instead of obtaining a TAN, the resident buyer can now fulfill their withholding tax obligations by quoting their **Permanent Account Number (PAN)**. The payment will be made via a PAN-based challan.
Objective	The move aims to simplify property-related compliance for NRIs and resident buyers, reducing the procedural burden of obtaining a TAN for one-off transactions and bringing parity between purchases from resident and non-resident sellers.
Effective Date	This amendment to Section 397(1)(c) is proposed to take effect from **1st October 2026**.

7.4.3 Aadhaar Linkages

Aadhaar is a twelve-digit unique identity number issued to residents based on biometric and demographic data. Over time, the law and rules have required or encouraged linking of Aadhaar with PAN and with tax accounts, subject to court rulings and privacy safeguards.

The main reasons for Aadhaar PAN linkage in tax administration are:

- To prevent multiple PANs being used by the same person.

- To improve the accuracy of pre filled data and e verification of returns.
- To help in locating non-filers and verifying identity without physical documents.

When PAN and Aadhaar are linked, the taxpayer can often verify their return using a one-time password sent to a mobile number that is registered with Aadhaar. This makes the process faster and reduces the need to send physical documents. At the same time, the use of Aadhaar in tax systems has raised debates on data protection and the limits of linking different databases, which are handled through separate legal and policy discussions.

Check your progress

Q1. In simple words, what is a tax return and why is it important for a taxpayer

Q2. What is the main difference between PAN and TAN in the tax system

7.5 OVERVIEW OF ASSESSMENTS: SUMMARY, SCRUTINY AND BEST JUDGMENT

After a taxpayer files a return, the tax department has to decide whether to accept it as it is or to examine it more closely. This process of verifying and finalising the tax liability is called assessment. In simple terms, three concepts are important: summary assessment, scrutiny assessment and best judgment assessment.

7.5.1 Summary Assessment

A summary assessment is a quick check of the return using automated systems and basic cross checks. The department does not call for detailed explanations in every case. Instead, it performs limited checks such as:

- Correct arithmetic in the return.
- Whether tax paid (through TDS, advance tax, self-assessment tax) matches what is claimed.
- Whether basic information like PAN and bank details are valid.

If the system finds that everything matches within certain limits, it may complete the assessment by issuing an intimation. This intimation may confirm that the return is accepted as filed or may point out

minor adjustments such as interest calculation differences. Many taxpayers go through only this stage, which is mostly automated, and do not face any deeper enquiry.

The **Budget 2026** documents and the **ELP Analysis**, below is an explanation of **Summary Assessment** (the initial processing of a tax return)

Summary Assessment (Processing of Return)

Feature	**Explanation**	**Latest Details & Changes (2026)**
What is it?	It is a preliminary check of the Income Tax Return (ITR) filed by the taxpayer. It is not a detailed investigation.	The focus is now on **"Trust-Based Tax Administration"** where the government trusts the data provided by the taxpayer initially.
Procedure	It is done automatically by computers (Centralized Processing). There is no human interaction involved.	The Budget 2026 emphasizes **"Technology-Driven & Digital Governance"** and **"Unified systems"** to process these returns with minimal manual intervention.
Area of checking	The system checks for: 1. Arithmetical errors (calculation mistakes). 2. Incorrect claims (like claiming a deduction that is not allowed). 3. Mismatch in tax paid vs. tax payable.	The goal is to provide **"Ease of Compliance"** and allow taxpayers to correct errors easily. The system aims for **"Faster assessments"** and quick processing.
The Result (Intimation)	After checking, the department sends a notice (Intimation) to the taxpayer. It states whether the return is accepted, if more tax is due, or if a refund is granted.	If there is an error, the new rules allow extended timelines for **"Revised and Updated returns"** so taxpayers can correct mistakes without fear of heavy penalties.
Refunds	If you have paid extra tax, the Summary	To improve liquidity for small taxpayers, the budget proposes automated processes for

	Assessment processes your refund.	issuing lower deduction certificates and refunds.
No Human Bias	Since it is automated, there is no personal bias or harassment by tax officers.	This aligns with the objective of shifting from an **"Enforcement-heavy regime"** to a **"Facilitative, trust-driven administration"**.

7.5.2 Scrutiny Assessment

In some cases, the department may decide that a return needs closer examination. This can happen randomly for sample checks or based on risk factors such as large claims of loss or credit, unusual patterns in data, or information received from other sources. When this happens, the case is selected for what is commonly called scrutiny assessment.

In a scrutiny assessment, the assessing officer (now often working through faceless systems) issues notices asking the taxpayer to provide more details, such as:

- Books of account and supporting documents.
- Break up of major expenses and receipts.
- Proof for certain claims like deductions or exemptions.

The aim is to see whether the income and tax declared are correct and whether any under reporting has occurred. After considering the material and any explanations, the officer passes an order determining the final tax. If there is a difference between what was originally declared and what is now assessed, additional tax, interest and sometimes penalty may become payable.

The **Finance Bill 2026** and the **ELP Union Budget Analysis**, below is a explanation of **Scrutiny Assessment**.

Scrutiny Assessment

Scrutiny Assessment is a detailed examination of an Income Tax Return to confirm that the taxpayer has not understated their income or computed excessive loss.

Feature	Explanation	Details as per 2026
Definition	It is a rigorous checking of the tax return where the tax officer asks for proof and documents to verify income and expenses.	Unlike Summary Assessment (which is automatic), this involves a detailed inquiry. The law ensures that income chargeable to tax has not escaped assessment.
Authority	It is conducted by the **National Faceless Assessment Centre** or specific Assessment Units.	The law defines the "Assessing Officer" to include the National Faceless Assessment Centre and assessment units, except for specific notices where the Jurisdictional Assessing Officer (JAO) has the power.
Faceless Nature	The taxpayer and the tax officer do not meet face-to-face. Everything is done online to prevent corruption and bias.	The system is designed so that the initiation of certain inquiries might be by a local officer, but the assessment is generally carried out through a **Faceless framework** to ensure transparency.
Time Limits	There are strict deadlines for the officer to complete the checking and pass an order.	**New Rule:** A new sub-section (10) is inserted in **Section 153** to clarify that the "draft order" must be made before the final time limit for assessment expires. This clears up confusion about deadlines.
Penalty Immunity	If the officer finds "Under-reported income" due to misreporting, you can still avoid a penalty by paying up.	**New Rule:** If a penalty is initiated for misreporting, the taxpayer can get **immunity** (waiver) from penalty and prosecution if they pay the tax, interest, and an **additional income tax** (100% of the tax payable).
Draft Order	In cases involving foreign transfers (Transfer Pricing) or non-residents, the officer first sends a "Draft Order" before the final bill.	The amendments clarify that the draft order must be passed within the time limits set by **Section 153**. This protects the taxpayer's right to object before the Dispute Resolution Panel (DRP).

Documentation	The officer examines books of accounts and documents.	If a person willfully fails to produce accounts or documents during this process, the law now proposes **decriminalization** or reduced imprisonment (simple imprisonment) for such procedural failures.

7.5.3 Best Judgment Assessment

Best judgment assessment is a concept used when a taxpayer does not cooperate or does not provide proper information, so that the officer cannot assess income in the usual way. For example, if a person does not file a return at all despite being required to, or does not respond to repeated notices, or keeps no reasonable records, the law allows the officer to estimate income based on available information and reasonable assumptions.

This is called best judgment because the officer must use their best judgment, not arbitrary guesswork. They may use data from similar businesses, third party information, bank records or past years to arrive at a figure. The taxpayer usually has the right to appeal against such assessments, but the risk of a high estimated income and additional tax is a strong reason to keep proper records and comply with notices in time.

7.6 ADVANCE TAX: CONCEPT

Advance tax means paying income tax during the year in which income is earned instead of paying the whole amount as a lump sum at the time of filing the return. The idea is that tax collection should move in step with income, which helps both the government and the taxpayer.

For example, a business owner who expects to earn significant profit in a year can estimate their likely tax and pay it in several instalments as specified by law. If they do not pay enough advance tax, they may have to pay interest later.

Advance tax is particularly important for people whose income is not entirely subject to deduction at source, such as self-employed professionals, business owners and those with large capital gains. Salaried individuals may also need to consider advance tax for income beyond salary, such as rental or interest income, unless their employer adjusts TDS to cover these amounts.

To manage advance tax properly, a taxpayer should:

- Make a realistic estimate of annual income and tax at the start and update it during the year if business results or other factors change.
- Note the due dates for advance tax instalments and the approximate share of total tax to be paid by each date.
- Review tax calculation after each instalment to correct any underpayment or overpayment.

Paying advance tax on time reduces interest costs and avoids a heavy cash flow impact at the end of the year. It also builds a habit of regular tax planning instead of last-minute action.

Advance Tax Procedure and Rules

Feature	**Rule / Procedure**	**Explanation**
Payer	**Tax Liability ≥ ₹10,000**	If your estimated tax for the year (after subtracting TDS) is **₹10,000 or more**, you must pay Advance Tax.
Who is Exempted	**Resident Senior Citizens**	If you are a Resident Senior Citizen (60 years or older) and you **do not** have any income from a Business or Profession, you do not need to pay Advance Tax.
Calculation	**Estimation**	1. Estimate your total income for the current year. 2. Calculate tax on it. 3. Subtract any **TDS/TCS** (Tax deducted/collected at source) already paid. 4. The remaining amount is your Advance Tax.
Payment Schedule	**Four Installments**	You cannot pay it all at once; you must follow a strict timeline (see schedule below).
Small Businesses	**Presumptive Scheme**	If you are a small business or professional opting for the "Presumptive Scheme" (declaring flat 6% or 8% or 50% income), you only need to pay

	(44AD/ADA)	**one installment** on or before **15th March**.
Failure to Pay	**Interest Penalty**	If you fail to pay or pay late, the government charges interest. Under the **Income-tax Act, 2025**, these interest penalties for default and deferment are covered under **Sections 424 and 425** (previously 234B and 234C).

Due Dates for Payment (Installments)

For normal taxpayers (companies, firms, and individuals), Advance Tax must be paid in four installments during the financial year:

Due Date	**Amount to be Paid**	**Meaning**
On or before 15th June	**15%**	You must pay at least 15% of your total estimated tax liability.
On or before 15th September	**45%**	You must have paid a total of 45% of your tax by this date (minus what you paid in June).
On or before 15th December	**75%**	You must have paid a total of 75% of your tax by this date.
On or before 15th March	**100%**	You must pay the entire remaining balance (100%) of your estimated tax liability.

Important Changes (Finance Bill 2026)

The **Finance Bill 2026** proposes updates to **Sections 424 and 425** (relating to interest for default/deferment of advance tax). It aligns the calculation of interest with the new **MAT (Minimum Alternate Tax)** credit provisions. Specifically, when calculating the tax paid, any tax credit allowed to be set off under the new rules (Section 206) will be considered.

7.7 TAX AUDIT: CONCEPT

Tax audit is a process in which a qualified professional, usually a chartered accountant, examines the accounts of a business or professional person to check whether they give a correct picture of income and whether certain tax law requirements are followed. It does not mean that the tax department itself is auditing the accounts at this stage. Instead, the law requires the taxpayer to get such an audit done and to submit the report with their return when their turnover, receipts or other indicators cross specified limits.

The main aims of tax audit are:

- To ensure that books of account are properly maintained and kept up to date.
- To report key details such as method of accounting, depreciation, loans and payments that are relevant for tax calculations.
- To help the tax department by presenting information in a standard format, which makes assessment easier.

A tax audit report usually contains a series of questions on whether certain provisions have been followed and lists important figures in a structured way. This reduces the scope for disputes later, because many potential issues are identified and noted at the audit stage itself.

From the taxpayer's point of view, tax audit is a compliance cost but also a form of protection. It acts as a second check on their own calculations and record keeping. If they maintain good records and respond properly to the auditor, it is more likely that any later assessment by the department will be smoother.

Tax Audit Rules (Section 44AB)

Feature	**Rule / Limit**	**Explanation**
Who must get audited? (Business)	**Sales > ₹1 Crore**	If a business has total sales (turnover) exceeding **₹1 Crore** in a year, a tax audit is mandatory.
Who must get audited? (Profession)	**Receipts > ₹50 Lakh**	If a professional (like a doctor, lawyer, architect) has gross receipts exceeding **₹50 Lakh** in a year, audit is mandatory.
Enhanced Limit	**Sales > ₹10 Crore**	If a business does **95%** of its receipts and payments digitally

(Digital Transactions)		(non-cash), the audit is required only if sales exceed **₹10 Crore**.
Exception (Small Taxpayers)	**Presumptive Scheme (44AD/ADA)**	If you opt for the Presumptive Scheme (declaring 6%, 8%, or 50% profit), you generally **do not** need an audit, even if turnover is up to ₹2 Cr (Business) or ₹75 Lakh (Profession).
When Exception Fails	**Declaring Lower Income**	If you are in the presumptive scheme but claim your profit is *lower* than the government's fixed rate (e.g., lower than 6% or 8%), you **must** get an audit done.
Due Date for Audit Report	**Before Return Filing**	The audit report must be obtained and furnished by the Chartered Accountant before the due date of filing the return of income.
Due Date for Return (Audit Cases)	**31st October**	Taxpayers who are required to get their accounts audited must file their Income Tax Return by **31st October** of the assessment year.

Important Changes in Budget 2026 (Penalty vs. Fee)

The **Finance Bill 2026** proposes significant changes regarding the punishment for not getting an audit done on time.

Item	**Old Rule**	**New Rule (Proposed for 2026)**
Consequence of Default	Penalty	Fee (Mandatory Payment)
Amount Payable	0.5% of Turnover or ₹1.5 Lakh (whichever is lower).	**₹75,000** for a delay of up to one month. **₹1,50,000** for a delay beyond one month.
Purpose of Change	To punish non-compliance.	To rationalize penalties into fees and reduce

		litigation (decriminalization).

7.8 COMPLIANCE CALENDAR FOR BUSINESS FIRMS

Business firms have many taxes related deadlines through the year. Having a simple compliance calendar helps them avoid missed dates, late fees and interest. The exact dates and forms can change with legal amendments and official notifications, and they can also differ depending on the size and type of business. However, a general outline can still be useful.

A basic compliance calendar for a typical business firm may include:

- Monthly or quarterly GST returns, where outward and inward supplies and tax payments are reported.
- Monthly payment of tax deducted at source, with quarterly TDS returns showing details of deductions made from salaries, contractors, rent and other payments.
- Four key dates in the year for payment of advance income tax instalments, except for very small taxpayers who may not be covered.
- An annual GST return summarizing transaction of the year.
- Filing of income tax return by the due date, which may differ depending on whether the accounts are subject to tax audit and whether the entity is a firm, company or other type.
- Filing of tax audit report by an earlier due date where the law requires such an audit.

Many firms prepare an internal list that translates these general items into specific dates, names of responsible staff members and reminders. Some use compliance software that sends alerts before each deadline and helps generate the relevant returns based on accounting data. Others rely on their external tax practitioners to manage these tasks, but even then, it is good practice for the firm's own managers to know the main dates so that they can provide data on time.

A well-maintained compliance calendar is not just about avoiding penalties. It also supports better cash flow management because firms can plan for tax payments instead of being surprised by large demands when returns are due.

The **Finance Bill 2026**, **Budget 2026 Analysis**, below is a Compliance Calendar for business firms. The 2026 Budget proposes significant changes to due dates, particularly for partners of firms and small businesses.

Compliance Calendar for Business Firms (Assessment Year 2026-27)

The following table outlines the key deadlines for filing Income Tax Returns (ITR), Tax Audit Reports, and Advance Tax payments.

Month / Date	Compliance Activity	Liability / Applicability
June 15	**Advance Tax (1st Installment)**	All businesses with tax liability > ₹10,000 must pay **15%** of estimated tax.
September 15	**Advance Tax (2nd Installment)**	All businesses must pay **45%** of estimated tax (cumulative).
September 30	**Tax Audit Report Filing**	Businesses required to get accounts audited (Sales > ₹1 Cr or ₹10 Cr if digital) must furnish the audit report one month before the return filing date (usually by Sept 30 for the Oct 31 deadline).
October 31	**Tax Audit Report Filing (Transfer Pricing)**	Businesses involved in international transactions must furnish the accountant's report one month before the return filing date (by Oct 31 for the Nov 30 deadline).
December 15	**Advance Tax (3rd Installment)**	All businesses must pay **75%** of estimated tax (cumulative).
March 15	**Advance Tax (4th Installment)**	All businesses must pay **100%** of estimated tax.
	Presumptive Tax Payment	Businesses under **44AD/44ADA** must pay 100% of their Advance Tax in a single installment by this date.
July 31	**ITR Filing (Normal Deadline)**	Individuals, HUFs, and businesses **not liable for audit**.

August 31	**ITR Filing (New Proposed Date)**	**Partners of Firms** (where accounts are not required to be audited) and **Businessmen** (not liable for audit).
October 31	**ITR Filing (Audit Cases)**	**Companies** and any assessee (like a Firm) whose **accounts are required to be audited**.
November 30	**ITR Filing (Transfer Pricing)**	Businesses that have entered into **international transactions** or specified domestic transactions (Transfer Pricing cases).
December 31	**Belated Return Deadline**	Last date to file a return if the original deadline was missed.
March 31*(Next Year)*	**Revised Return Deadline**	**New Change:** Last date to file a Revised Return to correct errors. Extended from Dec 31 to March 31 (12 months from end of tax year).

Key Compliance Concepts on 2026

1. Advance Tax (Pay as You Earn)

• **Rule:** If your estimated tax liability for the year is **₹10,000 or more**, you cannot wait until the end of the year to pay. You must pay it in four installments (June, Sept, Dec, March).

• **Exception:** Small businesses opting for **Presumptive Taxation** (Section 44AD/44ADA) only need to pay one installment on **March 15**.

2. Rationalization of Due Dates (2026 Amendment)

• Previously, partners of firms often had to file by July 31, while the firm (if audited) filed later.

• **New Rule:** To resolve this, the **Finance Bill 2026** proposes moving the deadline to **August 31** for partners of firms and businesses whose accounts do not require auditing.

3. Tax Audit Report

• If a business has a turnover exceeding **₹1 Crore** (or **₹10 Crore** if 95% transactions are digital), it must get its accounts audited by a Chartered Accountant.

• **Penalty to Fee:** The Finance Bill 2026 proposes converting the penalty for failure to furnish a tax audit report into a mandatory **fee** (₹75,000 for delay up to one month, ₹1,50,000 thereafter).

4. Revised and Belated Returns

• **Belated Return:** If you miss the due date, you can file by **December 31**.

• **Revised Return:** If you make a mistake, the new proposal allows you to correct it up to **12 months** from the end of the tax year (i.e., March 31 of the next year), subject to a fee.

5. TDS/TCS Certificates

• Businesses must issue certificates to those they have deducted tax from.

  ◦ **Form 16:** For Salary payments.

  ◦ **Form 16A:** For Non-Salary payments (like interest, professional fees).

  ◦ **Form 27D:** For Tax Collected at Source (TCS).

Check your progress

Q3. Briefly explain the idea of summary assessment and scrutiny assessment.

Q4. Why is advance tax especially important for business owners and self-employed persons

Q5. What is the purpose of a tax audit and how does it help both the taxpayer and the tax department

7.9LET US SUM UP

This unit has described the main procedural pillars of the Indian tax system from the viewpoint of a taxpayer and a business firm. We saw that filing returns is the basic way in which taxpayers report their income and tax payments, whether under income tax or GST. The move to electronic filing has made this process faster and more transparent, but also requires taxpayers to be comfortable with digital tools and to keep their information organised. Identification systems such as PAN and TAN ensure that income, deductions and collections can be matched across many different sources, while Aadhaar

linkages support verification and help avoid duplicate identities, though they also raise wider questions of data protection that are handled in other parts of law and policy.

We also learned that the tax department completes the process through different kinds of assessments, from quick summary checks to detailed scrutiny and, in rare non-compliant cases, best judgment estimates. Concepts like advance tax and tax audit encourage regular payment of tax and proper maintenance of accounts, which reduce the chance of heavy demands and disputes later. Finally, we emphasised the value of a practical compliance calendar for business firms, so that key dates for returns, payments and reports are not missed. By understanding this framework, a learner gains a clear picture of what it means to be a compliant taxpayer in India beyond simply knowing tax rates and heads of income.

CHECK YOUR PROGRESS

A. Fill in The Blank-

11. Taxes are broadly classified into _____ and _____ taxes.
12. Direct taxes are paid _____ to the government.
13. The burden of indirect tax is finally borne by the _____.
14. Income tax follows the principle of _____ taxation.
15. A tax charged per unit of goods is called a _____ tax.
16. GST has removed the _____ effect of tax.
17. Tax incidence refers to the _____ burden of tax.
18. VAT and GST are examples of _____ stage taxes.
19. A proportional tax is also known as a _____ tax.
20. In modern economies, revenue mainly comes from _____ taxes.

B. Answers –

1. Direct, Indirect 2. Directly 3. Consumer 4. Progressive 5.Specific 6.Cascading 7. Final 8. Multi 9. Flat 10. Direct.

C. Very Short Answer Questions-

6. What is a direct tax?
7. Define indirect tax.
8. What is tax incidence?
9. What is a proportional tax?
10. What is GST?

7.10 FURTHER READING

1. Basu, D. D. *Introduction to the Constitution of India* – Chapters on finance and taxation, for background on legal powers and procedures.
2. Singh, S. *System of Taxation in India* – Sections on income tax administration and compliance processes.
3. Ahuja, G., & Gupta, R. *Practical Approach to Income Tax* – Introductory chapters on PAN, TAN, return filing and assessments (conceptual overview).
4. Datey, V. S. *GST Ready Reckoner* – Chapters explaining GST registration, return filing and compliance for businesses in simple language.
5. Sengupta, A. *Direct Taxation: Law and Practice* – Parts dealing with assessment procedures, advance tax and tax audit concepts.
6. Official e-filing portal user guides of the Income Tax Department – Help sections on ITR forms, e-verification and advance tax calculators.
7. GST portal help manuals – Step-by-step guides for GST return filing, due dates and basic compliance for small businesses.
8. Institute of Chartered Accountants of India (ICAI) publications on *Tax Audit* and *Small and Medium Practitioner Manuals* – Conceptual notes on tax audit and compliance calendars for firms.

7.11 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q1: A tax return is a form in which a taxpayer reports their income, certain financial details and the tax due or paid for a year. It is important because it is the main way to inform the government that the person has followed tax law and to claim any refund that may be due.

Ans to Q2: PAN is a permanent account number that identifies a taxpayer in all direct tax matters. TAN is a separate number used by those who deduct or collect tax at source, and it is quoted in TDS and TCS related documents to track such deductions and collections.

Ans to Q3: In summary assessment, the department does a quick, mostly automated check of a return, focusing on maths and basic matching of data. In scrutiny assessment, the department examines the return in detail, asks for supporting documents and explanations, and then decides the final tax.

Ans to Q4: Advance tax is important for business owners and self employed persons because much of their income does not have tax deducted at source. If they do not pay tax in instalments during the year, they may face interest charges and a heavy cash outflow at the time of filing the return.

Ans to Q5: A tax audit checks whether the accounts of a business or professional person are properly kept and whether key tax related information is correctly reported. It helps the taxpayer by catching errors early and helps the department by presenting information in a standard format, which makes assessment easier and reduces disputes.

7.12 MODEL QUESTIONS

1. Describe the main steps in filing an income tax return through the electronic system for an individual or a small business, without going into computation of income.
2. Explain the roles of PAN, TAN and Aadhaar in India's tax procedure and discuss why linkages between these identifiers are used.
3. Distinguish between summary assessment, scrutiny assessment and best judgment assessment, giving simple examples of when each might be used.
4. Discuss the concept of advance tax and how it affects tax planning and cash flow management for a business firm.
5. What is a tax audit in the context of Indian income tax law Why is it required for certain taxpayers, and what are its advantages and possible drawbacks from the viewpoint of a business firm

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Unit 8: INDIAN INDIRECT TAX FRAMEWORK – OVERVIEW

UNIT STRUCTURE

8.1 Learning Objectives

8.2 Introduction

8.3 Meaning of Indirect Tax

8.3.1 Features of Indirect Tax

8.3.2 Difference between Direct Tax and Indirect Tax

8.3.3 Why Indirect Taxes are important for government revenue?

8.4 Evolution of Indirect Taxation in India

8.4.1 Indirect Tax System before GST

8.5 Introduction to GST

8.5.1 Types of GST

8.6 Place of Supply

8.7 Input Tax Credit

8.8 Indirect Tax impact on Pricing and Business Decisions

8.9 Let Us Sum Up

8.10 Further Readings

8.11 Answer to Check Your Progress

8.12 Model Questions

8.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- Explain the Meaning, benefits and drawbacks of Online Banking
- ATM; Advantages and Disadvantages
- NEFT, ECS, RTGS, IMPS in details
- Automated Clearing House
- Debit & Credit Card; Its Benefits and Risks

8.2 INTRODUCTION

Online banking is simply the use of electronic means to withdraw and transfer funds directly from one account to another, rather than by cheque or cash. It allows us to conduct banking transactions online, instead of finding a bank and interacting with a teller.

Indian banks are trying to make our life easier. Not just bill payment, we can make investments, shop or buy tickets and plan a holiday at our finger tips. This is so because of electronic banking. Online banking refers to effective deployment of electronic devices by the banks for banking transactions. These electronic based new alternative channels namely Automated Teller Machine (ATM), Phone banking, Tele banking, PC- Banking and most recently Internet Banking are replacing the conventional banking system.

8.3 MEANING OF INDIRECT TAX

Indirect taxes are those taxes which are charged on the goods and services that we consume in our day-to-day life. These taxes are termed *indirect* because the person who pays the tax to the government is not the one who finally bears its burden. Unlike direct taxes, where the tax burden is borne by the same person on whom it is imposed, indirect taxes are passed on from one person to another.

In the case of indirect taxes, the tax is first paid by the seller or service provider, but the final burden is ultimately borne by the consumer who uses the goods or services. For this reason, indirect taxes are also known as **consumption taxes**. These taxes are considered **regressive in nature** since they do not take into account the paying capacity of individuals and are charged uniformly on consumption.

Indirect taxes are generally levied on expenditure, consumption, privilege, or rights, and not directly on income or wealth. Prior to the introduction of GST, several indirect taxes were imposed in India. These included excise duty, customs duty, service tax, central sales tax (CST), value added tax (VAT), entry tax, purchase tax, entertainment tax, luxury tax, advertisement tax, and taxes on lottery, betting, and gambling.However, thesystem of indirect taxation in India underwent a major transformation with effect from **1st July 2017**, when a comprehensive indirect tax system was introduced in the form of **Goods and Services Tax (GST)**. Under this new system, many central and state-level indirect taxes were merged into a single tax structure. The introduction of GST marked a significant milestone in the reform of indirect taxes in India. At present, **Goods and Services Tax (GST)** and **Customs Duty** are the two main forms of indirect taxes in the country.

8.3.1 Features of Indirect Tax

Some of the significant features of indirect taxes are explained below:

1. **Important Source of Public Revenue**
   Indirect taxes constitute a major source of income for the government. In India, a substantial portion of total tax revenue is generated through indirect taxes.
2. **Transfer of Tax Liability**
   One of the key characteristics of indirect taxes is that the tax burden can be passed on. The seller or service provider shifts the tax burden to the final consumer through prices.
3. **Inflationary Tendency**
   By increasing the price of goods and services, indirect taxes may contribute to rising price levels in the economy.
4. **Less Resistance from Consumers**
   Since indirect taxes are included in the price of goods and services, consumers do not feel a direct burden while paying them, resulting in lower psychological resistance.

5. **Promotion of Social Objectives**

   Goods that are harmful to health or society, such as alcohol and tobacco, are taxed at higher rates. This helps in discouraging their consumption and improving social welfare.

6. **Regressive Nature**

   Indirect taxes are regressive because the tax amount remains the same for all consumers, irrespective of their income or ability to pay.

7. **Levy Based on Taxable Events**

   Indirect taxes are imposed when certain taxable events occur, such as manufacture, sale, purchase, import or export of goods, or the supply of service.

8.3.2 Difference between Direct and Indirect Tax

Meaning

Direct tax is a tax which is imposed on a person and paid directly by that same person to the government. In contrast, indirect tax is levied on goods and services, where the person who pays the tax to the government is not the one who finally bears its burden.

Burdenof Tax

In the case of direct taxes, the burden of tax cannot be shifted to another person. On the other hand, indirect taxes allow the transfer of tax burden from the seller or service provider to the final consumer through higher prices.

Incidence and Impact

Under direct taxes, the incidence and impact of tax fall on the same person. In indirect taxes, the incidence of tax is on the seller, while the impact is ultimately borne by the consumer.

Basis of Levy

Direct taxes are levied directly on income, wealth, or profits of individuals or organizations. Indirect taxes are levied on expenditure, consumption, or the occurrence of taxable events such as manufacture, sale, purchase, import, export, or supply of goods and services.

- **Nature of Tax**

Direct taxes are generally progressive in nature, as they take into account the paying capacity of taxpayers. Indirect taxes are regressive in nature because they are charged uniformly on consumption, without considering the income level of consumers.

- **Effect on Prices**

Direct taxes do not directly influence the prices of goods and services. In contrast, indirect taxes increase the prices of goods and services and may contribute to inflationary tendencies in the economy.

- **Visibility of Tax Burden**

In direct taxes, the tax burden is clearly visible to the taxpayer, as it is paid separately. In indirect taxes, the tax burden is hidden in the price of goods and services, making it less noticeable to consumers.

- **Resistance to Tax**

Direct taxes generally face greater resistance from taxpayers because they involve direct payment to the government. Indirect taxes face less resistance since they are included in the prices of goods and services and paid indirectly.

- **Examples**

Examples of direct taxes include Income Tax and Corporate Tax. Examples of indirect taxes include Goods and Services Tax (GST) and Customs Duty.

8.3.3Why Indirect Taxes are important for government revenue?

Indirect taxes play a crucial role in generating government revenue, especially in a developing economy like India. The importance of indirect taxes can be explained as follows:

1. **Major Source of Government Revenue**

Indirect taxes constitute a significant portion of the total tax revenue of the government. Taxes such as Goods and Services Tax (GST) and Customs Duty provide a steady and continuous flow of income to the government.

2. **Wide Tax Base**

   Indirect taxes are levied on goods and services consumed by people in their day-to-day life. Since consumption is widespread, indirect taxes cover a large section of the population, including those who may not fall under the direct tax net.

3. **Ease of Collection**

   Indirect taxes are relatively easier to collect compared to direct taxes. They are collected at the point of sale or supply of goods and services, reducing administrative costs and improving tax compliance.

4. **Less Resistance from Taxpayers**

   As indirect taxes are included in the prices of goods and services, taxpayers do not feel an immediate burden. This results in less opposition and greater acceptability of indirect taxes.

5. **Stable and Regular Revenue**

   Since consumption of essential goods and services continues regardless of economic conditions, indirect taxes provide a stable and regular source of revenue to the government.

6. **Contribution to Economic Regulation**

   By imposing higher taxes on harmful or luxury goods such as tobacco, alcohol, and luxury items, the government can regulate consumption while simultaneously earning revenue.

7. **Support to Fiscal Policy Objectives**

   Indirect taxes help the government achieve fiscal objectives such as resource mobilization, redistribution of income (to a limited extent), and economic stability through appropriate tax rates.

8. **Helpful in Tax Administration**

   Indirect taxes reduce the problem of tax evasion, as taxes are collected at multiple stages of production and distribution, particularly under GST through the input tax credit mechanism.

Indirect taxes are an indispensable source of government revenue due to their wide coverage, ease of collection, and steady inflow of funds. They play a vital role in financing public expenditure and supporting economic development.

8.4 EVOLUTION OF INDIRECT TAXATION IN INDIA

The system of indirect taxation in India has undergone significant changes over time. Before the introduction of Goods and Services Tax (GST), India had a complex structure of indirect taxes levied separately by the Central Government and the State Governments. These taxes were imposed at different stages such as manufacture, sale, provision of services, import, and export of goods. Due to multiple taxes, different tax laws, and lack of coordination between the Centre and the States, the indirect tax system suffered from inefficiencies like cascading effect, lack of uniformity, and higher compliance burden. Over the years, several reforms were undertaken, ultimately leading to the introduction of GST on 1st July 2017.

Indirect Taxes in the Pre-GST Regime

Before GST, a number of indirect taxes were levied by both the Central and State Governments. Each tax had a separate law, levying authority, and taxable event.

- **Central Excise Duty**

Central Excise Duty was levied by the Central Government under the Central Excise Act, 1944. It was imposed on the manufacture or production of goods in India. Initially, excise duty was charged on the gross value of goods, which led to a cascading effect of taxes. To reduce this, the MODVAT scheme was introduced in 1987, which was later replaced by the CENVAT Credit Scheme. However, excise duty was not levied on alcohol for human consumption and certain narcotic products, on which state excise duty was imposed.

- **Service Tax**

Service Tax was levied and collected exclusively by the Central Government under the Finance Act, 1994. It was imposed on the provision of taxable services. Although CENVAT credit was later extended to service tax, full credit across goods and services was not available, resulting in partial cascading of taxes.

- **Value Added Tax (VAT)**

VAT was levied by State Governments on intra-state sale of goods under respective State VAT Acts. Each state had its own VAT law and tax rates. The introduction of VAT was a major reform to replace the earlier sales tax system and reduce the cascading effect at the state level. The process of VAT implementation began in 2003, with Haryana being the first state to introduce VAT. By 2008, all states had adopted VAT.

- **Central Sales Tax (CST)**

Central Sales Tax was levied on inter-state sale of goods. Though collected by State Governments, it was governed by a central law. CST credit was not allowed against VAT, which created a break in the input tax credit chain and discouraged inter-state trade.

- **Customs Duty**

Customs Duty was levied by the Central Government under the Customs Act, 1962. It was imposed on import and export of goods. Credit of customs duty was not fully available for set-off against other indirect taxes.

- **Other State-Level Indirect Taxes**

Apart from VAT and CST, State Governments levied several other indirect taxes such as luxury tax, entertainment tax, entry tax, purchase tax, advertisement tax, and taxes on lottery, betting, and gambling. These taxes further increased the complexity of the tax system.

Problems in the Pre-GST Indirect Tax System

The pre-GST indirect tax system suffered from several shortcomings. There was multiplicity of taxes, different tax rates across states, and separate levying authorities. The same goods or services were often taxed multiple times by both Centre and States. Due to restrictions on cross-utilisation of input tax credit, the chain of ITC was not seamless. This resulted in tax being levied on tax, known as the cascading effect. Businesses faced higher costs, compliance burden, and lack of uniformity in taxation across the country.

Need for Reform and Introduction of GST

To overcome these issues, there was a strong need to reform the indirect tax system in India. The objective was to create a uniform tax structure, remove cascading effect, allow seamless flow of input tax credit, and integrate the Indian market. These objectives led to the introduction of Goods and Services Tax through the GST Act, 2017, which came into force on 1st July 2017.

Indirect Taxes in the Post-GST Regime

After the implementation of GST, most of the indirect taxes levied by the Centre and States were subsumed into GST. GST is a destination-based tax levied on the supply of goods and services and is collected concurrently by the Central and State Governments.

With the introduction of GST on 1st July 2017, most indirect taxes levied by the Centre and States were subsumed into a single tax structure. However, **not all indirect taxes were abolished**. Certain taxes such as **Customs Duty and State Excise Duty on liquor** continue to exist even after GST, though their **coverage and manner of levy have changed**. It is important for students to clearly understand this distinction.

The main indirect taxes after GST are:

1. Goods and Services Tax (GST)

GST replaced a large number of central and state indirect taxes such as excise duty (on most goods), service tax, VAT, and CST. GST is levied on the **supply of goods and services** and is collected concurrently by the Central and State Governments in the form of CGST, SGST/UTGST, and IGST. One of the major changes under GST is the availability of **seamless input tax credit across goods and services**, which was not possible in the pre-GST regime.

2. Customs Duty – Continuity with Structural Change

Customs Duty existed even before GST and continues to be levied after GST under the Customs Act, 1962. Earlier, customs duty consisted mainly of **Basic Customs Duty (BCD)** along with additional duties equivalent to excise duty and VAT, such as Countervailing Duty (CVD) and Special Additional Duty (SAD).

After the introduction of GST, **CVD and SAD were abolished**, and instead, **Integrated GST (IGST)** is levied on imports along with Basic Customs Duty. Thus, imports are now treated as **inter-state supplies under GST**. While Basic Customs Duty remains non-creditable, **IGST paid on imports is eligible for input tax credit**, thereby reducing the cascading effect. This marks a significant improvement over the pre-GST customs structure.

State Excise Duty – Restricted Scope after GST

Before GST, excise duty was levied by both the Centre and the States. Central Excise Duty was imposed on manufacture of goods, while State Excise Duty was levied mainly on alcohol and certain narcotic products.

After GST, **Central Excise Duty has been abolished on most goods**, except for a few petroleum products such as crude oil, petrol, diesel, aviation turbine fuel, and tobacco products. **State Excise Duty continues to be levied only on alcohol for human consumption and certain narcotics**, which are kept outside the GST framework. Thus, excise duty still exists, but its **scope has become very limited**.

4. Sales Tax on Liquor – Continued State Power

Even after GST, **states continue to levy sales tax/VAT on liquor for human consumption**. Liquor has been deliberately kept outside the purview of GST to protect state revenue. Therefore, states retain exclusive powers to tax both **production (state excise)** and **sale (sales tax/VAT)** of alcoholic liquor. This is a clear exception to the otherwise uniform GST structure.

It is important to note that **GST did not eliminate all indirect taxes**. Instead, it **subsumed multiple taxes into one**, while allowing certain taxes like Customs Duty and State Excise Duty to continue with **modified structure and limited scope**. Unlike VAT or Service Tax, which were completely replaced by GST, Customs Duty and State Excise Duty were **retained but restructured** to align with the GST framework.

Thus, the post-GST indirect tax system in India represents a **blend of continuity and reform**. While GST brought uniformity and removed cascading effect for most goods and services, certain strategic taxes continue to exist to safeguard revenue interests of the Centre and States.

8.5GOODS AND SERVICES TAX

Goods and Services Tax (GST) is a comprehensive, destination-based indirect tax introduced in India through the Constitution (101st Amendment) Act, 2016. It replaced multiple indirect taxes such as VAT, service tax, excise duty, and others, bringing them under one unified system. GST is levied on the supply of goods and services and is collected at each stage of value addition, with credit allowed for the tax paid at earlier stages. This ensures that the final tax burden falls only on the end consumer and avoids the problem of “tax on tax” (cascading effect).

Under GST, both the Central and State Governments have the power to make laws and levy tax, as provided under Article 246A of the Constitution. Accordingly, GST is divided into CGST (Central GST), SGST (State GST), and IGST (Integrated GST for inter-state supplies). This dual structure maintains a balance between the Centre and the States while creating a common national market with a simplified and transparent tax system.

8.5.1 Types of GST

CGST (Central Goods and Services Tax):

CGST is the tax collected by the Central Government on the supply of goods and services taking place within the same state (intra-state supply). Whenever a transaction occurs within a state, the GST charged is split into two parts, and CGST is one of them. The revenue collected under CGST is deposited with the Central Government. It helps the Centre to generate revenue from domestic trade while maintaining uniformity in the taxation system across the country.

SGST (State Goods and Services Tax):

SGST is the tax levied by the State Government on intra-state supply of goods and services. In such transactions, SGST is charged along with CGST. The amount collected under SGST goes to the respective State Government where the transaction takes place. This ensures that states continue to have their own source of revenue even after the introduction of a unified GST system.

IGST (Integrated Goods and Services Tax):

IGST is imposed by the Central Government on inter-state supply of goods and services, meaning when the supply takes place between two different states or in case of imports. The tax collected as IGST is later distributed between the Central and the destination State Government according to prescribed rules. This system ensures smooth flow of tax credit and avoids complications in inter-state trade.

UTGST (Union Territory Goods and Services Tax):

UTGST is applicable to intra-state supply of goods and services in Union Territories that do not have a State Legislature. In such territories, UTGST is charged instead of SGST along with CGST. The revenue collected under UTGST goes to the administration of the respective Union Territory, ensuring they also receive their share of tax revenue under the GST framework.

8.6 PLACE OF SUPPLY

Place of Supply denotes the place where the supply is consumed. GST is a destination based consumption tax, i.e the tax is levied on the consumption of supply at the destination. It determines the jurisdiction where the tax revenue should reach. It is important to determine the kind of tax that is to be charged (CGST+ SGST+ IGST+ UTGST). When the location of supplier and the place of supply are in two different states- interstates supply and IGST would be chargeable. And when they are in the same state, then it will be an intra- state supply and CGST/ SGST would be chargeable. Chapter V of the IGST Act (Sections 10 to 13) prescribes the provisions relating to place of supply of goods and services.

Place of Supply of Goods (Section 10 & 11 of IGST Act)

1. When goods are supplied and involve movement, the place of supply is the location where the movement of goods ends for delivery to the recipient.
2. When goods are delivered without movement (for example, goods picked up directly by the buyer), the place of supply is the location of the goods at the time of delivery.
3. If goods are delivered to a third person on the direction of the buyer (bill-to ship-to model), the place of supply is the principal place of business of the third person.
4. When goods are assembled or installed at a site, the place of supply is the location where the installation or assembly takes place.
5. If goods are supplied on board a conveyance such as a ship, aircraft, train, or motor vehicle, the place of supply is the location where the goods are taken on board.
6. In case of goods imported into India, the place of supply is the location of the importer.
7. For goods exported from India, the place of supply is considered to be outside India.
8. When goods are supplied through an agent to a recipient, the place of supply is the location where the goods are finally delivered.
9. If goods are supplied to an unregistered person and the address on record exists, the place of supply is the recorded address of the recipient.
10. In situations not specifically covered, the place of supply is determined based on the location of goods at the time of delivery.

Place of Supply of Services (Section 12 & 13 of IGST Act)

1. When both supplier and recipient are located in India, the place of supply is generally the location of the recipient of services.
2. If the service is provided to an unregistered person and the address is not available, the place of supply becomes the location of the supplier.
3. For services related to immovable property, the place of supply is where the property is located.
4. In case of restaurant, catering, personal grooming, fitness, or similar services, the place of supply is where the services are actually performed.
5. For training and performance appraisal services, the place of supply is the location where the services are carried out.
6. For admission to events such as exhibitions, fairs, or cultural programs, the place of supply is where the event is held.
7. For transportation of goods, the place of supply is the location of the recipient if registered, otherwise the place where goods are handed over for transport.
8. For passenger transportation services, the place of supply is where the passenger begins the journey.
9. For services provided on board a conveyance, the place of supply is the first scheduled point of departure of that conveyance.
10. When either the supplier or recipient is located outside India, the place of supply is determined based on the location of the recipient, and if not available, the location of the supplier.

8.7 INPUT TAX CREDIT

Input Tax Credit (ITC) is an important feature of GST that helps to remove the cascading effect of taxes, commonly known as “tax on tax.” Before GST, the tax paid to the Central Government could not be adjusted against the tax payable to the State Government, and the same applied in reverse. GST removed this barrier by creating a unified tax system where credit of tax paid at one stage can be used to reduce the tax liability at the next stage. This ensures that tax is levied only on the value added and the final burden falls on the ultimate consumer.

ITC allows a registered taxpayer to deduct the tax already paid on purchases (inputs) from the tax payable on sales (outputs). In simple words, the business does not have to pay tax again on

the same value. To claim ITC, the taxpayer must possess valid tax invoices for the goods or services received, and these goods or services must be used for business purposes.

Input Goods refer to goods, other than capital goods, that are used or intended to be used by a supplier in the course or furtherance of business. These goods help in carrying out business activities and are eligible for claiming input tax credit.

Input Service means any service that is used or intended to be used by a supplier for business purposes. Services such as transportation, consultancy, maintenance, and others that support business operations are considered input services for claiming ITC.

Input Tax refers to the GST charged on the supply of goods or services to a registered person. It includes CGST, SGST, IGST, or UTGST charged on purchases, tax paid on imports, and tax payable under reverse charge provisions as specified under GST laws.

Input Tax Credit is the credit of input tax that is self-assessed by the taxpayer and shown in the monthly GST returns. This credit appears under different heads such as IGST, CGST, and SGST/UTGST. The balance of ITC can be used only for payment of GST as per the prescribed rules and cannot be used for payment of interest, penalty, or any other charges.

The eligibility for claiming Input Tax Credit (ITC) under GST is allowed to only registered businesses for taxes paid on business inputs (goods/services) against their output tax liability, preventing tax cascading, but requires meeting conditions like having valid invoices, receiving goods, using them for taxable supplies, and filing returns, with specific exclusions for personal use or certain blocked credits. Key conditions include possessing valid tax documents, ensuring the supplier paid the tax, timely payment (within 180 days), and matching GSTR-3B with GSTR-2B, with strict time limits for claiming

8.8 INDIRECT TAX IMPACT ON PRICING AND BUSINESS DECISONS

ndirect taxes play an important role in determining the price of goods and services in the market. Since these taxes are included in the selling price, any change in tax rates directly affects the final price paid by consumers. When the rate of indirect tax increases, the cost of the product also rises, which may reduce demand. On the other hand, lower tax rates can make

goods and services more affordable and increase sales. Therefore, businesses must carefully consider the impact of indirect taxes while fixing the price of their products.

Indirect taxes also influence various business decisions such as production, purchasing, and distribution. Under the GST system, businesses can claim input tax credit on their purchases, which reduces the overall tax burden. This encourages firms to buy from registered suppliers and maintain proper documentation. Tax structure also affects decisions about the location of warehouses, choice of suppliers, and supply chain management, as companies try to minimize tax costs and improve efficiency.

Furthermore, indirect taxes affect competition and profitability. Businesses must adjust their pricing strategies to remain competitive while ensuring that tax compliance does not reduce their margins. Proper understanding of indirect tax provisions helps businesses plan better, avoid penalties, and make informed financial decisions. Thus, indirect taxation plays a significant role not only in pricing but also in shaping overall business strategies.

CHECK YOUR PROGRESS

What is meant by an indirect tax? Why is it called a consumption tax?

Q2: Mention any four important features of indirect taxes.

Q3: State two differences between direct tax and indirect tax.

Q4: Why are indirect taxes considered an important source of government revenue?

Q5: Name any four indirect taxes that existed in India before the introduction of GST.

Q6: What were the major problems in the pre-GST indirect tax system?

Q7: What is Goods and Services Tax (GST)? Why is it called a destination-based tax?

Q8: Distinguish between CGST, SGST, IGST, and UTGST.

Q9: What is meant by Place of Supply under GST?

Q10: When is IGST charged and when are CGST and SGST charged?

8.9LET US SUM UP

- Indirect taxes are levied on goods and services and are ultimately borne by the consumers. They form a major source of revenue for the government due to their wide coverage, ease of collection, and steady flow of income. These taxes have certain distinct features such as transfer of tax burden, regressive nature, and influence on prices and consumption patterns.
- Before the introduction of GST, India had a complex indirect tax structure with multiple taxes levied by the Centre and the States, leading to problems like cascading effect, lack of uniformity, and higher compliance burden. The need to remove these difficulties and create a common national market led to the introduction of Goods and Services Tax (GST) on 1st July 2017.
- GST is a destination-based tax levied on the supply of goods and services and is jointly administered by the Central and State Governments in the form of CGST, SGST/UTGST, and IGST. Important concepts under GST such as Place of Supply and Input Tax Credit (ITC) ensure proper distribution of tax revenue and removal of tax-on-tax effect. While GST has subsumed most indirect taxes, certain taxes like Customs Duty and State Excise on liquor continue to exist with limited scope.
- Indirect taxes also have a significant impact on pricing of goods and services and influence various business decisions related to purchasing, supply chain, and competitiveness. Overall, the reformed indirect tax framework under GST has brought greater transparency, uniformity, and efficiency into the Indian taxation system.

8.10 ANSWERS TO CHECK YOUR PROGRESS

Answer to Q1:

An indirect tax is a tax charged on goods and services that we use in daily life. It is called a consumption tax because the final burden of the tax is borne by the consumer who consumes the goods or services, not the person who directly pays it to the government.

Answer to Q2:

Four important features of indirect taxes are: transfer of tax burden to consumers, major source

of government revenue, inflationary tendency due to price rise, and regressive nature as it does not consider the income level of consumers.

Answer to Q3:
In direct tax, the burden cannot be shifted and is paid by the same person on whom it is imposed, whereas in indirect tax, the burden can be passed to the consumer. Direct taxes are levied on income or wealth, while indirect taxes are levied on consumption or expenditure.

Answer to Q4:
Indirect taxes are important because they have a wide tax base, are easier to collect, face less resistance from taxpayers, and provide a steady and regular source of revenue to the government.

Answer to Q5:
Before GST, indirect taxes included Central Excise Duty, Service Tax, VAT, Central Sales Tax (CST), Entry Tax, Luxury Tax, Entertainment Tax, and Customs Duty.

Answer to Q6:
The pre-GST system had multiple taxes, different tax rates in different states, lack of coordination between Centre and States, and restrictions on input tax credit, which led to the cascading effect of taxes and higher compliance burden.

Answer to Q7:
GST is a comprehensive indirect tax levied on the supply of goods and services. It is called a destination-based tax because the tax revenue goes to the state where the goods or services are consumed.

Answer to Q8:
CGST is collected by the Central Government on intra-state supplies. SGST is collected by the State Government on intra-state supplies. IGST is collected by the Central Government on inter-state supplies and imports. UTGST is collected in Union Territories without a legislature on intra-state supplies.

Answer to Q9:

Place of Supply refers to the place where goods or services are consumed. It helps determine whether the transaction is intra-state or inter-state and which type of GST should be charged.

Answer to Q10:
IGST is charged when the supplier and the place of supply are located in different states (inter-state supply). CGST and SGST are charged when both the supplier and the place of supply are in the same state (intra-state supply)

Answer to Q8: A debit card uses the money directly from your bank account when you make a purchase.
A credit card allows you to borrow money from the bank to make purchases and pay it back later.

Answer to Q9: NACH (National Automated Clearing House) was introduced by **NPCI (National Payments Corporation of India).**

Answer to Q10:Clearing, time, Deposit, pay

8.11 FURTHER READING

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 Government of India GST Portal: Official guidance, Acts, Rules, and Updates.

8.12 MODEL QUESTIONS

Q1. Explain the meaning and main features of indirect taxes. Why are they considered regressive in nature?

Q2. Distinguish between direct tax and indirect tax with suitable points of difference.

Q3. Discuss the importance of indirect taxes as a major source of government revenue in India.

Q4. Describe the structure of indirect taxation in India before the introduction of GST and point out its major shortcomings.

Q5. Explain the need for GST in India. How did GST remove the problems of the pre-GST system?

Q6. What is Goods and Services Tax (GST)? Explain its objectives and basic structure.

Q7. Describe the different types of GST—CGST, SGST, IGST, and UTGST—with examples.

Q8. What is meant by Place of Supply under GST? Explain the rules relating to place of supply of goods and services.

Q9. What is Input Tax Credit (ITC)? Explain its importance and the conditions required to claim ITC.

Q10. Discuss how indirect taxes influence pricing and business decisions.

UNIT 9: ECONOMIC IMPACT OF TAXATION

UNIT STRUCTURE

9.1 Learning Objectives

9.2 Introduction

9.3 Impact of Taxation

9.3.1 Impact on Production

9.3.2 Impact on Distribution

9.3.3 Impact on Consumption, Savings and Investment

9.3.4 Impact on Economic Stability

9.4 Tax buoyancy and tax elasticity

9.5 Black money: Concepts and concerns

9.6 Tax incentives and their economic effects

9.7Let Us Sum Up

9.8Further Readings

9.9Answer to Check Your Progress

9.10Model Questions

9.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- Explain Digital India initiatives in the taxation system
- Identify and use major online tax portals
- Understand PAN, TAN, and Aadhaar-based tax mechanisms
- Describe e-filing and digitized assessment processes
- Understand the role of AI, analytics, AIS, and TIS in tax administration
- Explain e-invoicing and real-time reporting systems

9.2 INTRODUCTION

9.2.1 Overview of Digital Programme in India

The **Digital India Programme**, launched in 2015, aims to ensure that government services are made available to citizens electronically. The programme focuses on digital infrastructure, digital delivery of services, and digital literacy.

Key components of Digital India include:

- Digital infrastructure as a utility for every citizen
- Governance and services on demand
- Digital empowerment of citizens

In the context of taxation, Digital India has facilitated the creation of online portals, electronic databases, and technology-based compliance systems. These initiatives have significantly reduced human intervention and improved service delivery in tax administration.

9.2.2 Digitalisation of Tax Administration in India

Digitization of tax administration refers to the use of information technology to manage tax-related processes such as registration, return filing, assessment, payment, and communication.

Major developments in digitized tax administration include:

- Online registration and filing of tax returns
- Electronic payment of taxes
- Digitized records and databases
- Faceless and automated assessment systems
- Online communication between taxpayers and tax authorities

The introduction of platforms such as the **Income Tax Portal**, **GST Network (GSTN)**, and **MCA Portal** has enabled seamless interaction between taxpayers and the government. Digitization has reduced paperwork, processing time, and administrative costs while improving accuracy and accountability.

9.2.3. Objective of Digital Taxation imitative

The key objectives of implementing Digital India initiatives in taxation are:

- To simplify tax compliance procedures
- To reduce tax evasion and increase the tax base
- To improve transparency and accountability in tax administration
- To minimize human interface and discretionary powers
- To provide faster and efficient services to taxpayers

These objectives aim to create a taxpayer-friendly environment while strengthening revenue collection.

9.2.4. Benefits of Digitalisation in Taxation

Digitization has brought several benefits to both taxpayers and tax authorities, such as:

- Ease of compliance and convenience
- Faster processing of returns and refunds
- Reduction in errors and duplication
- Improved transparency and trust

- Better monitoring and data analysis

For tax authorities, digitization enables better data management, risk assessment, and policy formulation.

9.3 IMPACT OF TAXATION

Taxation is a very important fiscal instrument along with public expenditure and public borrowing. Besides its primary function as an instrument of resource mobilization, taxation can also be used to bring about various desirable objectives in the economy. Thus, a typical taxation policy will strive to attain: optional allocation of resources so that the maximum growth rate is achieved, economic stability by checking price and output fluctuations while maintaining an acceptable level of employment in the economy, and equality in the distribution of income and wealth by facilitating a redistribution process. This is while ensuring that the revenue mobilized is adequate for the effective functioning of the state. Given its far-reaching effects on the economy, a good taxation policy requires the fulfillment of the above objectives at the maximum level. In the following section, we discuss the manifold effects of taxation on production, distribution and economic stability

9.3.1Impacton Production

According to Dalton, taxation affects production through its effects on —Effects on ability to work, save and invest: Taxation reduces the purchasing power of the taxpayer. This leads to a direct reduction in his consumption affecting his ability to work. The effect is more on the poorer sections of the society who may even fail to consume adequate quantities of essential goods and services due to the imposition of the tax. As taxation reduces the deposable income of the people, it has a direct adverse impact on their savings. Reduction in Disposable income : Income after taxation saving erodes the source of investment. Hence, taxation by reducing disposable income diminishes the volume of saving and investment. Willingness to work, save and invest: Taxation affects different individuals' willingness to work, save and invest, differently. This happens because individuals' attitude towards work, saving and investment in the context of taxation differs. An individual who seeks to maintain his standard of living will work harder when he is burdened with a tax. He will do so to compensate for the income forgone as tax with

additional earnings. On the contrary, if the individual is not concerned about maintaining his pre-tax standard of living, then imposition of tax may seriously hamper his incentive to work. The tax payer here will not be willing to work hard since a large portion of his income is taken away as tax payments. At this point, it is pertinent to note that the incentive to work is more adversely affected by direct tax than by indirect tax. This is because the burden of direct tax is more severe on the tax payer than that of indirect tax. In the case of business firms, the decision to work, save and invest depends on a lot of complex factors. However, the overriding determinant of any business decision is the expectation of profit. Thus, so far the imposition of taxation does not seriously hamper profit expectations, taxation will not adversely affect the willingness to work, save and invest of this category of taxpayers. Diversion of economic resources: Taxation can not only affect the size and growth of production, but it also has an influence on its composition. Thus by imposing high rates of taxation on a particular industry, public authorities can induce a diversion of resources, from it to some other industry or industries. For example, tobacco industry is subject to high rates of taxation to affect its growth and to divert economic resources from it to some other beneficial sectors like textile, health, education etc. Similarly, diversion of resources may be brought about from one developed region to another region that is relatively underdeveloped, by imposing high taxation rates in the former region relative to low taxation or even subsidy grants in the second region. Thus, taxation can be utilized as an instrument to bring about balanced development in an economy

9.3.2 Impact on Distribution

One of the important objectives of public Finance is to reduce the inequality in the distribution of income and wealth. Accordingly, taxation is used as one of the principle instruments of redistribution so as to establish a more equalitarian society. Direct taxes are usually progressive in nature where the rich are taxed more heavily than the poor. The resources so mobilized are used to finance public expenditure on items like health, housing, education etc. which usually benefit the poorer sections of the society. The direct taxes result in a redistribution of income and wealth in favour of the poorer sections of the population. On the contrary, indirect taxes tend to be regressive in nature. Also referred to as commodity tax, these taxes have t be paid equally per unit of goods and services consumed, by both the rich and the poor. Given the fact that the burden on the poor is more than on the rich, indirect taxes have a tendency to induce a redistribution of income against the poor and in the process aggravate inequality in the economy. However, an indirect tax structure formulated with due sensitivity can to a great extent, be made progressive. Hence under such a structure luxury goods which are consumed

mostly by the rich can be heavily taxed which will enable the public authorities to subsidise essential items which are usually purchased by the poor. Here, it becomes viable to have a redistribution of income and wealth in favour of the poor, even with the imposition of indirect taxes

9.3.3 Impact on Consumption, Savings and Investment

Taxation has a direct influence on how individuals and businesses use their income. It affects the level of consumption, the ability to save, and the willingness to invest in the economy. The type, rate, and structure of taxes determine how income is divided among these three important economic activities.

Taxation affects **consumption** by reducing the disposable income of people. When individuals pay income tax and indirect taxes like GST, the money available for spending decreases. Higher taxes reduce purchasing power and may discourage the consumption of goods and services, especially luxury or non-essential items. On the other hand, lower taxes increase disposable income and encourage spending, which raises demand in the market. Thus, taxation can be used as a tool to regulate consumer behavior and control inflation.

Taxation also influences **savings** because savings depend on the income left after meeting consumption needs and paying taxes. High taxes reduce the amount of surplus income available for saving. However, governments often provide tax benefits and deductions on various savings schemes such as PPF, LIC, and fixed deposits to encourage people to save. These tax incentives motivate individuals to develop the habit of saving and invest their money in secure financial instruments.

Taxation has a significant impact on **investment** decisions of both individuals and firms. High corporate taxes may discourage businesses from expanding their operations or starting new ventures. In contrast, tax concessions, exemptions, and subsidies encourage investment in important sectors like infrastructure, manufacturing, and startups. Taxes on capital gains and dividends also affect investment in shares and other financial assets. A favorable tax system promotes investment, leading to capital formation and economic growth.

In conclusion, taxation plays an important role in shaping consumption, savings, and investment patterns in an economy. A well-designed tax system can guide economic resources towards productive uses and support overall development.

9.3.4 Impact on Economic Stability

Inherent to a free market economy are the phases of economic upswings and downswings. An upswing is associated with abnormal inflationary pressures on the economy leading to sustained and significant increase in the price level. Conversely, during a downswing, deflationary pressure on the economy leads to falling prices. Taxation can be used as a fiscal instrument to maintain the price level stability in both the two conditions. Thus, during an economic upswing, price rise can be checked by soaking up the excess purchasing power in the hands of the people. This can be achieved by raising the rates of existing taxes, imposing new taxes, and by doing away with subsidies. On the contrary, additional purchasing power needs to be pumped into the economy to check falling prices that characterise an economic downswing. Thus deflationary pressure can be largely controlled and reversed by cutting the rates of existing taxes, withdrawing some of the taxes, and increasing the level of tax exemptions and subsidies.

CHECK YOUR PROGRESS

Q1: State whether the following the statements are True (T) or False (F) :

(a) Resource mobilization is the sole motive of taxation (True/ False)

(b) High Tax rates imposed on particular industry can induce a diversion of resources from it to other industries. (True/False)

Q2: Why are the indirect taxes regressive? (Answer in about 40 words)

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9.4 TAX BUOYANCY AND TAX ELASTICITY

Tax buoyancy and tax elasticity are concepts used to understand how tax revenue responds when the income of a country increases. These measures help to judge the performance and efficiency of a tax system in generating revenue as the economy grows.

Tax Buoyancy shows how much tax revenue increases when national income increases, taking into account all changes made by the government in tax rates, tax structure, and methods of tax collection. When the government introduces new taxes, increases tax rates, or improves tax administration, tax revenue rises. This combined effect of economic growth and government action is known as tax buoyancy. A tax system is said to be buoyant if tax revenue grows faster than the growth of national income.

Tax Elasticity, on the other hand, measures the increase in tax revenue only due to the growth of national income, assuming there are no changes in tax rates, tax laws, or tax structure. It reflects the natural ability of the tax system to generate more revenue automatically as people earn more income. Tax elasticity indicates how strong and effective the existing tax system is without any government intervention.

In simple terms, tax buoyancy includes the effect of policy changes, while tax elasticity measures only the automatic response of tax revenue to income growth. A sound tax system should have high tax elasticity, as it shows that the system can generate sufficient revenue even without frequent changes in tax policies.

9.5 BLACK MONEY: CONCEPT & CONCERNS

Black money refers to income that is earned but not reported to the government for tax purposes. It includes money obtained through both illegal activities and legal activities that are hidden to avoid paying taxes. Such income is kept outside the formal economy and is not recorded in official accounts.

The **concept of black money** is closely related to tax evasion, corruption, and lack of transparency in financial transactions. People may generate black money by underreporting income, maintaining false accounts, dealing in cash without records, accepting bribes, or engaging in illegal trade. Since this money is not declared, the government loses revenue that could have been used for public welfare and development.

Black money creates several **economic concerns**. It reduces the tax base of the country and affects government revenue. It also leads to inequality, as people with unaccounted wealth gain unfair advantages over honest taxpayers. Black money often circulates in the parallel economy, causing inflation, especially in sectors like real estate, gold, and luxury goods.

There are also serious **social and political concerns**. Black money encourages corruption, weakens trust in public institutions, and promotes unethical practices in business and governance. It may also be used for illegal activities such as smuggling, money laundering, and financing unlawful operations.

To control the problem of black money, the government adopts measures such as strict tax laws, digital transactions, transparency in financial dealings, demonetization measures, and international cooperation to track undisclosed foreign assets.

In conclusion, black money is a major challenge for a developing economy. Controlling it is essential for ensuring fairness, improving tax collection, and maintaining economic stability.

9.6 TAX INCENTIVES AND THEIR ECONOMIC EFFECTS

Tax incentives are concessions or benefits provided by the government to reduce the tax burden on individuals and businesses. These incentives are given to encourage certain economic activities that are considered beneficial for the growth and development of the country. They may take the form of tax exemptions, deductions, rebates, lower tax rates, or tax holidays.

The main purpose of tax incentives is to guide resources towards priority sectors such as agriculture, small-scale industries, exports, infrastructure, and startups. By reducing the tax liability, the government motivates investors and entrepreneurs to invest in these areas. This leads to increased production, employment generation, and balanced regional development.

Tax incentives also influence the savings behavior of individuals. Deductions and exemptions available on savings schemes such as provident funds, insurance policies, and other financial instruments encourage people to save more. These savings can then be used for productive investments in the economy.

For businesses, tax incentives reduce the cost of production and improve profitability. This encourages firms to expand their operations, adopt new technologies, and invest in research and development. As a result, the overall industrial growth of the country improves.

However, excessive or poorly designed tax incentives may lead to revenue loss for the government and misuse by taxpayers. Therefore, tax incentives should be carefully planned and properly monitored to ensure that they achieve their intended objectives.

In conclusion, tax incentives play an important role in promoting economic activities, encouraging savings and investment, and supporting economic development when used in a balanced and effective manner.

9.7 FISCAL DEFICIT & TAXATION LINK

Fiscal deficit arises when the total expenditure of the government exceeds its total revenue, excluding borrowings. It shows the gap between what the government earns and what it spends in a financial year. This gap is usually met through borrowing, which increases the public debt of the country.

Taxation has a direct connection with fiscal deficit because taxes are the primary source of government revenue. When tax collection is low due to poor compliance, tax evasion, or a narrow tax base, government revenue declines. At the same time, government expenditure on welfare, infrastructure, and public services continues to rise. This imbalance between low revenue and high expenditure leads to a fiscal deficit.

An efficient tax system can help in reducing the fiscal deficit. Broadening the tax base, improving tax administration, and ensuring better compliance can increase tax revenue without necessarily increasing tax rates. When tax revenue rises, the government becomes less dependent on borrowings to meet its expenditure.

Sometimes, the government may increase tax rates or introduce new taxes to control the fiscal deficit. However, very high taxes can discourage consumption, savings, and investment, which may slow down economic growth. Therefore, taxation policies must be carefully designed to balance revenue generation and economic activity.

9.8 CHECK YOUR PROGRESS

Q1. What is the main aim of the Digital India Programme in taxation?

Q2. Name two major online taxation portals in India.

Q3. What does PAN stand for?

Q4. Why is TAN important?

Q5. What is the purpose of linking PAN with Aadhaar?

Q6. Mention one benefit of e-filing for taxpayers.

Q7. What is meant by faceless assessment?

Q8. What is AIS in taxation?

Q9. What is the role of the Invoice Registration Portal (IRP) under GST?

Q10. How does real-time reporting improve compliance?

9.9 LET US SUM UP

 Taxation is an important fiscal tool that influences production, distribution, consumption, savings, investment, and overall economic stability.

 Tax policy can be used to divert resources from harmful sectors to productive and priority sectors for balanced development.

 Progressive direct taxes help in reducing inequality, while a carefully designed indirect tax structure can also support redistribution.

 Taxation affects consumption by changing disposable income, influences savings through tax benefits, and guides investment through incentives and concessions.

 During inflation and deflation, taxation acts as a stabilizing instrument by controlling excess or deficient purchasing power.

 Tax buoyancy measures the growth of tax revenue due to both economic growth and government tax measures, whereas tax elasticity measures the natural growth of revenue without policy changes.

 Black money refers to unreported income that weakens the tax system, increases inequality, and creates economic and social problems.

 Measures such as strict laws, digital transactions, and transparency are necessary to control the generation of black money.

 Tax incentives encourage savings, investment, employment generation, and development of priority sectors, but they must be carefully monitored to avoid misuse.

 There is a close link between taxation and fiscal deficit, as efficient tax collection reduces the need for government borrowing.

 A well-structured tax system ensures economic growth, fairness, stability, and effective resource mobilization for public welfare.

11.10 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: a) False b) True

Ans to Q No 4: Indirect taxes are regressive in nature because, these taxes have to be paid equally per unit of goods and services consumed, by both the rich and the poor. As a result, it adversely affects the poorer sections of the society than the richer sections

11.11 FURTHER READING

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11.12 MODEL QUESTIONS

1. Explain how taxation influences production and allocation of resources in an economy.
2. Discuss the impact of taxation on distribution of income and wealth.
3. Describe the effect of taxation on consumption, savings, and investment.
4. How can taxation be used as a tool to maintain economic stability during inflation and deflation?
5. Define tax buoyancy and tax elasticity. Clearly distinguish between the two concepts.
6. What is black money? Discuss its major economic and social concerns.
7. Explain the meaning of tax incentives. How do they promote economic development?
8. Discuss the relationship between fiscal deficit and taxation.
9. "A well-designed tax system can promote growth as well as equity." Explain this statement with suitable arguments. *(Moderate)*
10. Critically examine the role of taxation as an instrument of economic planning, redistribution, and stabilization in a developing economy.

UNIT 10: PUBLIC FINANCE AND TAXATION

UNIT STRUCTURE

10.1 Learning Objectives

10.2 Introduction

10.3 Public Revenue

- **10.3.1 Need for Public Revenue**
- **10.3.2 Tax Revenue &Non Tax Revenue**

10.4 Public Expenditure & Its types

10.5 Budget

- **10.5.1 Components of Budget**
- **10.5.2 Types of Budget**

10.6 Fiscal Policy: Instruments & Objectives

- **10.6.1 Instruments of Fiscal Policy**
- **10.6.2 Objective of Fiscal Policy**

10.7 Fiscal federalism & tax sharing

10.8 Let Us Sum Up

10.9 Further Readings

10.10 Answer to Check Your Progress

10.11 Model Questions

10.1 LEARNING OBJECTIVES

After going through this unit, learners will be able to:

- Understand the concept and importance of **public finance, public revenue, and public expenditure**.
- Explain the meaning, components, and different **types of budget**.
- Describe the **instruments and objectives of fiscal policy**.
- Understand the concept of **fiscal federalism and tax sharing** between centre and states.
- Recognise the role of **digital initiatives in modernising the Indian taxation system**.

10.2 INTRODUCTION

Public finance and taxation constitute the backbone of government functioning and economic administration. Through public finance, the government mobilises resources from the economy, allocates them for various developmental and welfare activities, and ensures the smooth running of the state. This unit introduces the basic concepts of public revenue and public expenditure, explaining how the government raises funds and how these funds are utilised to satisfy collective needs, promote social welfare, and maintain economic stability.

The unit further explains the concept of the budget as an annual financial plan of the government, along with its components and different types. It discusses fiscal policy and its instruments, highlighting how taxation, public expenditure, and public borrowing are used to achieve objectives such as growth, equity, price stability, and employment. The idea of fiscal federalism and tax sharing is also presented to show how financial powers and responsibilities are divided between the centre and the states in a federal system. In addition, the unit outlines how digital initiatives have modernised the Indian taxation system, making tax administration more transparent, efficient, and taxpayer-friendly. Together, these topics provide a comprehensive understanding of the role of public finance and taxation in governance and development.

10.3PUBLIC REVENUE

Public revenue constitutes a part of the public receipt. It is an important source of revenue mobilisation of a state. Through public revenue, the state mobilises funds without incurring a corresponding increase in its debt obligation. To put it simply, funds mobilised as public revenue are income to the state and hence does not need to be returned. Another characteristic of public revenue is that it is recurring in nature. Thus, public revenue is mobilised year after year, and hence constitutes a reliable and perennial source of state funds.

10.3.1 Need for Public Revenue

We have already mentioned that like any other economic units, the state requires resources to maintain it and also to carry out all its activities. These resources are raised from various sources of the economy and by various means. Among all the sources, tax revenue constitutes the most important source for mobilisation of state funds. Tax revenue (along with non-tax revenue and capital receipts) are mobilised by the state to finance its various activities designed to attain the stated economic and social objectives. Among various economic objectives, revenue receipts are used to achieve the most optimal allocation of resources so as to achieve the highest possible growth rate. Besides, an appropriate taxation strategy is adopted to maintain price stability during the periods of economic fluctuations. Public revenue instruments are often used as fiscal tools to strive for the social objective of an egalitarian society. Thus, besides mobilising resources for the state, public revenue instruments also facilitate the endeavour towards the establishment of a more equal society. As mentioned above, although most of the expenditures of the state can be financed through public borrowing (i.e., capital receipt), however, this is not a sustainable option. In the long run, any expenditure programme of the state can only be sustained if it is covered by public revenue. This, in fact, constitutes the greatest significance of public revenue.

CHECK YOUR PROGRESS

Q1: State whether the following statements are True (T) or False (F)

(a) Capital Receipt is another term for non-revenue receipt. (True/ False) (b) Public revenue increases the debt obligation of the state. (True/False)

Q 2 : Distinguish between revenue receipt and capital receipt. Which one is the more sustainable source of public expenditure?

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10.3.1 Tax Revenue and Non Tax Revenue

Public revenue is the income of the state that is mobilised from the economy. Broadly, public revenue can be classified into tax revenue and non-tax revenue. Tax revenue: Tax revenue is the revenue mobilised by the state through taxation. This, in fact, constitutes the most important source of revenue of a state. A Tax is defined as a compulsory payment made to the state without any direct 'quid-pro-quo' between the tax payers and public authorities. Thus, the two basic characteristics of tax are It is a compulsory payment. There is no direct benefit extendable to the tax-payer. Tax revenue can be classified into direct taxes and indirect taxes. The principal direct taxes include income tax, corporation tax and consumption tax. The first two taxes are imposed on income whereas the third is imposed on expenditure. Besides, direct taxes are also imposed on property and also include wealth tax, death duty, gift tax and land revenue. On the other hand, indirect taxes are essentially taxes on commodities and resources that are offered for sale. They are imposed in the form of sales tax, excise duty, custom duties and value added tax (VAT). (We will study the different type of direct and indirect taxes in unit 4) Non–tax revenue: Besides tax revenue, non–tax revenue constitutes another source of revenue receipt for the state. The major non-tax revenues are broadly classified and briefly explained under the following heads:

Commercial revenues: Commercial revenues accrue to the state as it produces and supplies goods and resources to the public. This type of revenue accrues in the form of: dividend as it accrues to the state from the profit earned by the public sales enterprises, and price that is paid by the public while consuming goods and services which is provided by government owned public utilities.

Administrative revenues: The government extends various public services through its administrative infrastructure like civil and police administration, agriculture and allied services,

transport and communication, education, medical and various other services. From administrative services, revenue accrues to it which is referred to as Administrative revenue. Administrative revenue also arises in the form of fees, licences, permits, fines and forfeitures and special assessments. Finally, non–tax administrative revenue can also accrue as grants, gifts and escheats.

Earnings from currency and credit: The government earns an income as it mints coins and issues currencies. These constitute an important source of non–tax revenue. Besides, the interest earned from government lendings also constitutes non-tax revenue.

10.4 PUBLIC EXPENDITURE

Public expenditure is the expenditure incurred by the public authorities (i.e., central, state or local governments) for: • satisfying the collective needs of the citizens, • for promoting the economic and social welfare of the society, and • the defence of the country from external aggression. Traditionally, in Economics literature, public expenditure was considered to be an unavoidable evil and it was advised that it should be limited to the “three basic duties of the sovereign”, viz., maintenance of law and order, defence against foreign aggression and undertaking various public works. Such an attitude can be attributed to the universal acceptance of the policy of “laissez–faire” which calls for non-intervention by the government in the economy. This translates into the perception that “that state is best which governs the least”. However, in recent times, and especially after the great depression of the 1930’s in Europe, the role of public expenditure as an important instrument of fiscal policy, is getting more and more recognition. Thus, besides the traditional functions of the state as mentioned above, public authorities now have the added responsibility of securing the • optimum allocation of resources, • maintaining economic stability along with an acceptable growth rate and employment level, and • ensuring an equitable distribution of income and wealth. And all these objectives are sought to be achieved by the state using the instrument of public expenditure along with other fiscal instruments such as public revenue and public borrowing.

10.5 BUDGET & ITS TYPES

A **budget** is a planned statement of income and expenditure for a specific period, usually one financial year. It shows how much money is expected to be received and how much is proposed

to be spent. In simple terms, a budget is a financial plan that helps in managing resources in an organized and disciplined manner.

For a **government**, the budget is an annual financial plan presented before the legislature. It outlines the estimated revenue from various sources such as taxes, fees, and borrowings, and the proposed expenditure on public services like education, health, defence, infrastructure, and welfare schemes.

10.5.1 Components of a Budget

A government budget is broadly divided into different parts to clearly show the sources of income and the areas of expenditure. These components help in understanding how the government raises funds and how those funds are utilized for public purposes.

1. Revenue Receipts

Revenue receipts are the incomes that the government earns regularly and which do not create any liability or reduce its assets.

a) **Tax Revenue** – Income from taxes such as income tax, GST, customs duty, excise duty, etc.
b) Non-Tax Revenue – Income from sources other than taxes such as fees, fines, interest on loans, dividends from public enterprises, etc.

2. Capital Receipts

Capital receipts are those receipts which either create a liability for the government or reduce its assets.

a) Borrowings – Loans taken from the public, banks, or foreign institutions.
b) Recovery of Loans – Money received from states or other bodies as repayment of earlier loans.
c) Disinvestment – Income from selling shares of public sector enterprises.

3. Revenue Expenditure

Revenue expenditure refers to the day-to-day expenses incurred by the government for its normal functioning. These expenses do not create any assets.

Examples include salaries of government employees, subsidies, interest payments, maintenance of services, pensions, etc.

4. Capital Expenditure

Capital expenditure is the spending done by the government to create assets or reduce liabilities. It contributes to the development of the economy.

Examples include construction of roads, bridges, schools, hospitals, investment in machinery, and repayment of loans.

10.5.2 Types of Budget

Budgets can be classified in different ways depending on their purpose, preparation, and financial position. The main types of budgets are explained below:

Balanced budget: When a budget shows that the proposed expenditure and anticipated revenue are equal, it is said to be a balanced budget. A balanced budget never indicates a deficit or surplus. To maintain a balanced budget is rather difficult, if not impossible, in a developing country.

Unbalanced budget: A budget is said to be unbalanced, when the proposed expenditure and anticipated revenue are not equal. The imbalance implies either surplus or deficit budget. If there is excess of revenue over expenditure then it implies a surplus budget and in case of deficit budge there is excess of expenditure over revenue.

Revenue budget: When a budget consists of revenue receipts of the government and the expenditure made from these revenues then it is known as revenue budget. Revenues include receipts from the taxes and other duties, fee and other receipts for services rendered by the government, interest, dividends etc.

Capital budget: Capital budget consists of capital receipts and payments and the expenditure made from such receipts. The main items of capital receipts are the loan raised by the government from the public, borrowings of the government from the Central Bank, loans received from the foreign government and other organisations, recoveries of loans granted by the central government to the state government, revenue received through divestment, small savings such as provident fund, post office savings deposits, Kisan Vikas Patras, NSS deposits etc.

Interim budget: When a budget is prepared for an interim period i.e. for a period less than a full year then it is known as an interim budget. Normally such a budget is prepared to meet the expenditure in the intervening period if there is a delay in preparing a regular budget for the full year. The government of the day presents an interim budget if it does not have the time to present a full budget or because of the close proximity of national elections. In the latter situation, propriety demands that the task of framing the full budget be left to the incoming government. The budget for the year approved by Parliament gives the government spending rights only till the end of the financial year. If for any reason the government is not able to present a full budget before the financial year ends, it will need parliamentary authority for incurring expenditure in the new fiscal year until a full budget is presented. Through the interim budget, the Parliament passes a vote-on-account that allows the government to meet the expenses of the administration until the new Parliament considers and passes the budget for the whole year.

Supplementary budget: A supplementary budget is made to meet the extra expenditure over and above what is provided in the regular budget under either of the following circumstances: When during the course of a regular budget, the expenditure exceeds the revenue. When the government is required to incur expenditure on some specific projects for which no provision was made in the regular budget. Emergency budget: When a budget is prepared to meet the emergency situations such as war, depression, natural calamities etc. then that budget is known as emergency budget.

Zero Based Budgeting: Zero-base budgeting is an innovative technique where the budget manager is required to justify his budget from the scratch (i.e. hence zero base). Thus, here the budget not only has to justify the new proposals but also has to justify the expenditure incurred on the ongoing and past operations. Thus, in the words of Peter A. Phyrr, “Zero base budgeting is a planning and budgeting process which requires each manager to justify his entire budget

request in detail from scratch and shifts the burden of proof to each manager to justify why he should spend money at all for a particular activity under his charge". Zero-base budgeting has the following advantages over conventional budgeting Leads to more effective allocation of resources. Imparts more flexibility in the allocation and reallocation of resources. Avoids duplication of tasks Strengthens the evaluation process and leads to greater accountability Enables the budget to meet its objectives more efficiently

CHECK YOUR PROGRESS

Q 1: State whether the following statements are True(T) or False(F):

(a) The financial year in India is from 1st of March to 28th of February. (True/False)

(b) The government needs prior sanctions to spend from the contingency fund. (True/False)

Q 2: What is meant by budget? (Answer in about 40 words)
.....
.....
.....
..... Q 3: Distinguish between interim budget and supplementary budget. (Answer in about 40 words)
.....
.....
.....

10.6 FISCAL POLICY

Fiscal Policy refers to the policy under which the state uses its three budgetary instruments i.e., taxation, public expenditure and public borrowing, to achieve various economic and social objectives. Thus, for example, taxation may be used to encourage or discourage the production of a particular commodity without considering its primary function(i.e, revenue mobilisation) to be the sole deciding factor in adopting that policy. Similarly, the primary function of public expenditure and public borrowing are social objectives, when these two instruments are used as part of a fiscal policy. Thus, in a fiscal policy the three budgetary instruments, i.e, taxation,

public expenditure and public borrowing, are collectively used over and above their primary functions to achieve various economic and social objectives

10.6.1 Instruments of Fiscal Policy

The various instruments of fiscal policy are as follows

Public Expenditure: Public Expenditure is an important tool of fiscal policy. The appropriate variation in public expenditure can have more direct effect upon the level of economic activity than even taxes. The increased public spending will have a multiple effect upon income, output and employment exactly in the same way as of increased investment has its effect on them. Similarly, a reduction in public spending can reduce the level of economic activity through the reverse operation of the government expenditure multiplier.

Taxation: Taxation is a powerful instrument of fiscal policy in the hands of public authorities which greatly affect the changes in disposable income, consumption and investment. An anti-depression tax policy increases disposable income of the individual, promotes consumption and investment. Obviously, there will be more funds with the people for consumption and investment purpose at the time of tax reduction. This will ultimately result in the increase of spending activities.

Government Borrowing: The third fiscal instrument is government borrowing. Public debt policy influences aggregate demand through the volume of liquid assets. When the government floats a loan there is a transfer of liquid funds from the public to the government which reduces the purchasing power of the public. At the time of interest payments and repayment of debt, there is transfer of funds from the government to the public which increases the purchasing power in the hands of the public.

Public Budget : A public budget is a financial statement indicating the expected receipts and proposed disbursement in the coming fiscal year.We will discuss in details about public budget in next unit.

Public Works : Keynes has highlighted public works programme as the most significant anti-depression device. There are two forms of expenditure. These are – Public Works and Transfer Payments. The public works include - roads, rail-tracks, schools, parks, buildings, airports, hospitals, irrigation canals etc. Transfer payments are payments like interest on public debt,

subsidy, pension, insurance, social security benefits etc. Public works are supported as an anti-depression device on the following grounds : They reduces unemployment They increase the purchasing power of the community and thereby stimulate the demand for consumption goods They help to create economically and socially useful capital assets.

10.6.1 Objectives of Fiscal Policy

The objectives of fiscal policy are disussed below

Full employment: Full employment is a common objective of fiscal policy in both developed and developing countries. Fiscal policy should aim at reducing the extent of unemployment and under- employment. Public expenditure on social overheads, public sector enterprises all help to create employment opportunities. Tax holidays and subsidies to start industries in rural areas help to generate employment.

Price Stability: Price stability is an important objective for all countries in general. Fiscal policy should aim at avoiding both depression aninflation. Little rise in prices is considered as an incentive for capital formation and investment but high rate of inflation would remove the gains of development. There will be imbalance between aggregate demand and aggregate supply. To accelerate the rate of economic growth : Primarily, fiscal policy in a developing economy, should aim at achieving an accelerated rate of economic growth. But high rate of economic growth cannot be achieved and maintained without stability in the economy. Therefore fiscal measures should be used properly, so that production, consumption and distribution may not be adversely affected. It should promote the economy as a whole which in turn helps to raise national income and per capita income.

Optimum allocation of resources: Resources are scarce in developing economy. Hence, optimum allocation of such scarce resources becomes a primary objective of fiscal policy. Fiscal measures can greatly affect the allocation of resources in various occupations and sectors.

Equitable distribution of wealth and income: Extreme inequalities of income and wealth are harmful to economic development. Such inequalities exist in a large extent in developing countries. Suitable fiscal policy of the government can be devised to bridge the gap between the incomes of the different sections of the society.

Economic Stability: Fiscal measures promote economic stability in the face of short-run international cyclical fluctuations. These fluctuations cause variations in terms of trade, making the most favourable to the developed and unfavourable to the developing economies. So, for the purpose of bringing economic stability, fiscal methods should incorporate flexibility in the budgetary system so that income and expenditure of the government may automatically provide compensatory effect on the rise or fall of the nation's income.

Capital Formation and Growth: Fiscal policy can be adopted as a crucial tool for the promotion of the highest possible rate of capital.

10.7 FISCAL FEDERALISM & TAX SHARING

A federation is formed by the coming together of many states, which has a central government and various state governments. Depending on the type of the federation, the political and fiscal responsibilities are shared by the centre and the states. In practice, the functions that pertain to the entire nation are assumed by the centre. Thus, for example, defence, foreign affairs etc. are always the responsibility of the centre. Besides, the functions that require inter-state co-ordination is also entrusted to the central government, e.g., tele- communication, railways etc. On the other hand, the functions which are of the concern to the states are entrusted to the state governments. Thus, for example, agriculture, education, public health etc. fall in the domain of the states. Given the fact that the functions in a federation are divided between the centre and the states, it becomes necessary that each tier of government be given a source of revenue which is viable, sustainable and adequate so that they are able to fulfil their responsibilities. Then, there is also the need for a mechanism by which the pool of revenue in a country can be distributed among the central, state and local governments. The gamut of issues surrounding the sharing of the revenue of a country between the different tiers of the government is referred to as 'fiscal federalism'. In fiscal federalism, two issues need to be addressed: The diversity issue which concerns the need to satisfy the local needs and aspirations. The equivalence issue which focuses on the need to ensure that no state or region is discriminated against. Thus, we have discuessed that the basic issues of fiscal federation are the assignment of functions and the source of finance between different tiers of governments. Its domain of operations includes evolving a mechanism to: resolve fiscal imbalances, arbitrate inter-governmental disputes, and foster harmonious inter- governmental relationship.

Tax sharing: The main purpose of tax sharing is to help the state governments to bridge the gap between revenue expenditure and revenue receipts. The arrangements of tax sharing

between the centre and the states may be as per provision laid down in the constitution or as suggested by an expert committee

10.8LET US SUM UP

This unit presented a detailed discussion on **public finance and taxation** with special reference to the changing nature of tax administration in India under the **Digital India initiative**.

The unit began by explaining how digitisation has transformed the Indian taxation system from traditional, paper-based procedures to **technology-enabled, transparent, and efficient mechanisms**. It described the objectives and advantages of digital taxation such as ease of compliance, reduction of tax evasion, improved transparency, and faster delivery of services. The role of major online platforms like the **Income Tax Portal, GSTN, and MCA Portal** was highlighted to show how digital infrastructure supports smooth interaction between taxpayers and authorities. The importance of **PAN, TAN, Aadhaar linkage, e-filing, faceless assessment, AIS, TIS, AI-based analytics, and e-invoicing** was also discussed as key features of modern tax governance.

The concept of **public revenue** was then explained as a major source of government income that does not create debt obligations and is recurring in nature. The **need for public revenue** was examined in relation to resource mobilisation, economic growth, price stability, and social justice. Public revenue was classified into **tax revenue** and **non-tax revenue**, and the characteristics and examples of each were discussed in detail.

The unit further described **public expenditure** as the spending by government authorities to meet collective needs, promote welfare, and ensure economic stability. It explained how the role of public expenditure has expanded over time from limited sovereign functions to broader developmental and welfare responsibilities.

The discussion on the **budget** clarified its meaning as an annual financial plan of the government. The **components of the budget**—revenue receipts, capital receipts, revenue expenditure, and capital expenditure—were explained to show how funds are raised and utilised. Different **types of budgets** such as balanced, surplus, deficit, revenue, capital, interim, supplementary, emergency, and zero-based budgeting were also described.

The unit then introduced **fiscal policy**, explaining how taxation, public expenditure, and public borrowing are used together to achieve economic and social objectives. The **instruments and objectives of fiscal policy** such as full employment, price stability, equitable distribution of income, optimum allocation of resources, economic growth, and stability were discussed.

Finally, the concept of **fiscal federalism and tax sharing** was explained to show how financial powers and responsibilities are divided between the central and state governments in a federal structure, and how revenue sharing ensures balanced development and harmony among different levels of government.

Overall, this unit provided a comprehensive understanding of **public finance, budgeting, fiscal policy, and the digital transformation of taxation in India**, highlighting how modern technology and sound financial management contribute to effective governance and economic development.

10.9 ANSWERS TO CHECK YOUR PROGRESS

Q1.

(a) **False**

(b) **False**

Q2.

A budget is an annual financial plan of the government that shows the estimated receipts and proposed expenditure for a financial year. It helps in proper planning, allocation, and control of public resources to achieve economic and social objectives.

10.10 FURTHER READING

1) Bhatia, H.L. (2005). Public Finance. New Delhi : Vikas Publishing House Pvt. Ltd.

2) Lekhi, R.K. (2006). Public Finance and Fiscal Policy. Ludhiana: Kalyani Publishers.

3) Menkar, V.G. and Sarma, L.S. (2001). Public Finance : Theory and Practice. Mumbai: Himalaya Publishing House.

4) Prakash, O. (2008). Public Economics : Theory and Practice. Jalandhar: Vishal Publishing House

5) Economic & Political Weekly (EPW) – Articles on taxation policy and governance.

10.11 MODEL QUESTIONS

Short Answer Questions (About 40–60 words)

1. Explain the need for public revenue.
2. Distinguish between tax revenue and non-tax revenue.
3. What is public expenditure? State its objectives.
4. Explain the meaning and components of a budget.
5. Differentiate between revenue receipts and capital receipts.
6. Distinguish between revenue expenditure and capital expenditure.
7. What is meant by a balanced and an unbalanced budget?
8. Write a short note on zero-based budgeting.
9. What is fiscal policy? Name its instruments.
10. What is meant by fiscal federalism and tax sharing?

Long Answer Questions

11. Discuss the concept of public revenue and explain its classification.
12. Explain public expenditure and its changing role in modern economies.
13. Describe the meaning, components, and different types of budget in detail.
14. Elaborate the instruments and objectives of fiscal policy.
15. Explain the concept of fiscal federalism and its importance in a federal country like India.

UNIT 11: DIGITAL TRANSFORMATION IN TAXATION

UNIT STRUCTURE

11.1 Learning Objectives

11.2 Digital India Initiatives Related to Taxation

11.3 Online Taxation Portals – Overview

11.4 PAN, TAN, and Aadhaar-Based Systems

11.5 E-Filing and Digitized Assessment Concepts

11.6 Use of Artificial Intelligence, Analytics, and Technology in Tax Administration

11.7 E-Invoicing and Real-Time Reporting

11.8 Let Us Sum Up

11.9 Further Readings

11.10 Answer to Check Your Progress

11.11 Model Questions

11.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- Explain Digital India initiatives in the taxation system
- Identify and use major online tax portals
- Understand PAN, TAN, and Aadhaar-based tax mechanisms
- Describe e-filing and digitized assessment processes
- Understand the role of AI, analytics, AIS, and TIS in tax administration

- Explain e-invoicing and real-time reporting systems

11.2 DIGITAL INDIA INITIATIVES RELATED TO TAXATION

11.2.1 Overview of Digital Programme in India

The **Digital India Programme**, launched in 2015, aims to ensure that government services are made available to citizens electronically. The programme focuses on digital infrastructure, digital delivery of services, and digital literacy.

Key components of Digital India include:

- Digital infrastructure as a utility for every citizen
- Governance and services on demand
- Digital empowerment of citizens

In the context of taxation, Digital India has facilitated the creation of online portals, electronic databases, and technology-based compliance systems. These initiatives have significantly reduced human intervention and improved service delivery in tax administration.

11.2.2 Digitalisation of Tax Administration in India

Digitization of tax administration refers to the use of information technology to manage tax-related processes such as registration, return filing, assessment, payment, and communication.

Major developments in digitized tax administration include:

- Online registration and filing of tax returns
- Electronic payment of taxes
- Digitized records and databases
- Faceless and automated assessment systems
- Online communication between taxpayers and tax authorities

The introduction of platforms such as the **Income Tax Portal**, **GST Network (GSTN)**, and **MCA Portal** has enabled seamless interaction between taxpayers and the government. Digitization has reduced paperwork, processing time, and administrative costs while improving accuracy and accountability.

11.2.3. Objective of Digital Taxation imitative

The key objectives of implementing Digital India initiatives in taxation are:

- To simplify tax compliance procedures
- To reduce tax evasion and increase the tax base
- To improve transparency and accountability in tax administration
- To minimize human interface and discretionary powers
- To provide faster and efficient services to taxpayers

These objectives aim to create a taxpayer-friendly environment while strengthening revenue collection.

11.2.4. Benefits of Digitalisation in Taxation

Digitization has brought several benefits to both taxpayers and tax authorities, such as:

- Ease of compliance and convenience
- Faster processing of returns and refunds
- Reduction in errors and duplication
- Improved transparency and trust
- Better monitoring and data analysis

For tax authorities, digitization enables better data management, risk assessment, and policy formulation.

11.3 ONLINE TAXATION PORTALS – OVERVIEW

Online taxation portals are digital platforms developed by the Government of India to facilitate **electronic tax compliance and administration**. These portals enable taxpayers to perform

various tax-related activities such as registration, return filing, tax payment, verification, and compliance reporting in a **paperless and user-friendly manner**. They play a crucial role in implementing Digital India initiatives in taxation.

The major online taxation portals include the **Income Tax Portal**, **Goods and Services Tax Network (GSTN)**, and the **Ministry of Corporate Affairs (MCA) Portal**. The Income Tax Portal provides services related to income tax return filing, PAN-related activities, refunds, notices, and e-assessments. GSTN acts as the technological backbone for GST implementation by facilitating registration, return filing, invoice matching, tax payments, and compliance monitoring. The MCA Portal enables companies and LLPs to fulfill statutory filing, registration, and compliance requirements under corporate laws.

These portals are interlinked and supported by advanced technologies such as data analytics, automation, and digital authentication systems. Online taxation portals reduce manual intervention, improve transparency, enhance efficiency, and ensure ease of compliance. Overall, they form the foundation of **technology-driven tax governance in India**, benefiting both taxpayers and tax authorities

11.3.1 Income Tax Portal: Structure, Services, and Functionalities

The **Income Tax Portal** is an official online platform of the Income Tax Department of India, designed to provide end-to-end electronic services to taxpayers. It acts as a single interface between taxpayers and tax authorities.

Structure of the Income Tax Portal:

- User-based access for individuals, firms, companies, and tax professionals
- Secure login using PAN, password, and multi-factor authentication
- Centralized database for taxpayer information
- Integrated grievance redressal and communication system

Services and Functionalities:

- Online registration and PAN-based login
- E-filing of Income Tax Returns (ITR) and forms
- Electronic payment of taxes

- Viewing and responding to notices and intimations
- E-verification of returns using Aadhaar OTP, DSC, or net banking
- Tracking refund status
- Faceless assessment, appeal, and rectification services

The portal ensures transparency, faster processing, and improved taxpayer services.

11.3.2 Goods and Services Tax Network (GSTN): Role and Operational Framework

The **Goods and Services Tax Network (GSTN)** is a non-profit organization that provides the technological backbone for the implementation of the Goods and Services Tax (GST) in India.

Role of GSTN:

- Facilitation of GST registration for taxpayers
- Processing of GST returns and payments
- Invoice matching and input tax credit reconciliation
- Providing data to tax authorities at the Centre and States

Operational Framework:

- GSTN acts as a common platform connecting taxpayers, banks, and tax authorities
- Supports online filing of returns such as GSTR-1, GSTR-3B, and others
- Integration with the Invoice Registration Portal (IRP) for e-invoicing
- Use of analytics for compliance monitoring and risk assessment

GSTN improves efficiency, ensures uniformity in tax administration, and reduces tax evasion.

11.3.3Ministry of Corporate Affairs (MCA) Portal: Compliance and Reporting Overview

The **MCA Portal** is an online platform developed by the Ministry of Corporate Affairs for regulating companies and Limited Liability Partnerships (LLPs) in India.

Compliance and Reporting Functions:

- Online incorporation of companies and LLPs
- Filing of statutory returns and forms

- Submission of financial statements and annual returns
- Director Identification Number (DIN) services
- Compliance with Companies Act and LLP Act

The MCA Portal ensures transparency, timely compliance, and easy access to corporate information.

11.3.4Integration and Data Sharing among Portals

Integration among the Income Tax Portal, GSTN, and MCA Portal plays a crucial role in strengthening tax governance.

Key Aspects of Integration:

- PAN serves as a common identifier across all portals
- Data sharing helps in cross-verification of income, turnover, and financial statements
- Integration supports risk profiling and detection of tax evasion
- Enables seamless exchange of information between tax authorities

This integrated digital ecosystem enhances transparency, improves compliance, and supports data-driven decision-making in tax administration.

11.4 PAN, TAN, and Aadhaar-Based Systems

11.4.1 Concept and Importance of PAN and TAN

The **Permanent Account Number (PAN)** is a unique ten-digit alphanumeric identification number issued by the Income Tax Department to taxpayers in India. PAN acts as a **common identifier** for all tax-related transactions of an individual or entity.

Importance of PAN:

- Mandatory for filing income tax returns
- Used for tracking financial transactions
- Helps prevent tax evasion
- Acts as a universal tax identification number

The **Tax Deduction and Collection Account Number (TAN)** is a ten-digit alphanumeric number required for entities responsible for **deducting or collecting tax at source**.

Importance of TAN:

- Mandatory for TDS/TCS returns
- Ensures proper credit of tax deducted
- Enables tracking of tax deducted on behalf of taxpayers

PAN and TAN together help in ensuring **accurate tax reporting and compliance**.

11.4.2. Aadhaar-Based Identification and Authentication

Aadhaar is a unique 12-digit identification number issued by the Unique Identification Authority of India (UIDAI) based on biometric and demographic data of individuals.

Role of Aadhaar in Taxation:

- Acts as a digital identity for taxpayers
- Enables electronic verification (e-KYC)
- Facilitates secure and paperless authentication
- Used for e-verification of tax returns and services

Aadhaar-based authentication enhances security, reduces identity fraud, and improves efficiency in tax administration.

11.4.3. Linking of PAN–Aadhaar and Its Role in Compliance

Linking PAN with Aadhaar is a mandatory compliance requirement introduced to strengthen the tax system.

Objectives of PAN–Aadhaar Linking:

- Elimination of duplicate and fake PANs
- Accurate identification of taxpayers
- Better tracking of income and transactions
- Improved transparency in tax administration

This linkage ensures that all financial transactions are mapped to a **single verified identity**, helping tax authorities monitor compliance more effectively.

11.4.4. Use of Identification Systems in Monitoring and Control

PAN, TAN, and Aadhaar collectively form the backbone of **technology-driven monitoring and control mechanisms** in taxation.

Key Uses:

- Tracking high-value financial transactions
- Matching income reported with third-party data
- Monitoring TDS/TCS compliance
- Detecting tax evasion and non-filing cases
- Enabling data analytics and risk profiling

These identification systems support **data integration across portals** and promote effective tax governance.

11.5 E-FILING AND DIGITIZED ASSESSMENT CONCEPTS

11.5.1. Electronic Filing of Returns and Forms

Electronic filing (e-filing) refers to the submission of tax returns, statements, and statutory forms through official online portals of the tax department. In India, e-filing is primarily carried out through the **Income Tax Portal** and **GST Portal**.

E-filing enables taxpayers to file:

- Income Tax Returns (ITR)
- TDS/TCS returns
- GST returns and forms
- Statutory declarations and responses

The process generally involves online registration, preparation of returns using utilities or online forms, submission through the portal, and **electronic verification** using Aadhaar OTP, digital signature, or net banking. E-filing ensures accuracy, speed, and convenience in tax compliance.

11.5.2. Benefits of E-Filing for Taxpayers and Administration

E-filing offers several advantages to both taxpayers and tax authorities.

Benefits to Taxpayers:

- Convenience of filing returns anytime and anywhere
- Faster processing and refund issuance
- Reduced paperwork and manual errors
- Easy access to past records and acknowledgements
- Secure and transparent communication with tax authorities

Benefits to Tax Administration:

- Improved efficiency and reduced administrative costs
- Centralized digital records and data management
- Better monitoring and compliance tracking
- Enhanced transparency and accountability
- Use of analytics for risk assessment and policy formulation

Overall, e-filing simplifies compliance and strengthens the tax system.

11.5.3. Digitized and Faceless Assessment System

Digitized assessment refers to the conduct of tax assessments using electronic systems without physical interaction between taxpayers and tax officials. The **faceless assessment system** was introduced to ensure fairness, transparency, and uniformity.

Key Features of Digitized and Faceless Assessment:

- No physical appearance of the taxpayer before tax officers
- Allocation of cases through automated systems
- Communication through electronic modes only

- Use of centralized data and analytics
- Standardized procedures across jurisdictions

This system minimizes human bias, reduces corruption, and ensures objective decision-making in tax assessments.

11.5.4. Technology-Enabled Notices, Scrutiny, and Appeals

With digitization, tax administration has adopted **technology-enabled communication and dispute resolution mechanisms**.

Technology-Enabled Notices:

- Notices and intimations are issued electronically through portals
- Alerts via email and SMS
- Digital access to documents and responses

Electronic Scrutiny:

- Selection of cases based on data analytics and risk profiling
- Online submission of documents and explanations
- Time-bound and transparent scrutiny process

Digital Appeals and Rectification:

- Online filing of appeals and rectification requests
- Faceless appellate proceedings
- Electronic communication and order issuance

These technology-driven processes ensure efficiency, transparency, and quicker resolution of tax matters.

11.6 USE OF ARTIFICIAL INTELLIGENCE, ANALYTICS, AND TECHNOLOGY IN TAX ADMINISTRATION

With the advancement of digital technologies, tax administration in India has increasingly adopted **Artificial Intelligence (AI), data analytics, and automated systems** to improve efficiency, transparency, and compliance. These technologies enable tax authorities to analyze large volumes of data, identify risks, and ensure effective monitoring of taxpayers. The use of AI-driven tools supports data-based decision-making and reduces manual intervention in tax administration.

11.6.1 Application of AI and Data Analytics in Tax Management

Artificial Intelligence and data analytics are widely used in modern tax administration to manage and process large amounts of taxpayer data.

Key applications include:

- Automated processing of tax returns and forms
- Data matching between reported income and third-party information
- Identification of inconsistencies and anomalies in tax data
- Predictive analysis for revenue forecasting
- Automation of routine tasks such as return processing and refund issuance

By leveraging AI and analytics, tax authorities can enhance operational efficiency and improve the accuracy of tax administration.

11.6.2. Risk Assessment, Profiling, and Fraud Detection

AI and analytics play a vital role in **risk-based tax administration**.

Risk Assessment and Profiling:

- Taxpayers are categorized based on compliance behavior
- Selection of cases for scrutiny using data-driven models
- Focus on high-risk cases instead of random selection

Fraud Detection:

- Detection of fake invoices and circular trading
- Identification of tax evasion and non-filing cases
- Analysis of transaction patterns and financial behavior

These technology-driven systems help tax authorities minimize tax evasion and improve compliance without increasing administrative burden.

11.6.3. Annual Information Statement (AIS): Concept and Significance

The **Annual Information Statement (AIS)** is a comprehensive digital statement that provides a detailed view of a taxpayer's financial transactions during a financial year.

Concept of AIS:

- Consolidates data received from multiple sources
- Includes information on income, investments, expenditures, and taxes
- Available to taxpayers through the Income Tax Portal

Significance of AIS:

- Enhances transparency and accuracy in income reporting
- Helps taxpayers verify and reconcile financial data
- Enables tax authorities to cross-check reported income
- Reduces disputes and mismatches during assessment

AIS acts as a key tool in technology-driven compliance monitoring.

11.6.4. Taxpayer Information Summary (TIS) and Data Reconciliation

The **Taxpayer Information Summary (TIS)** is a simplified version of AIS that provides summarized information of key financial transactions.

Features of TIS:

- Categorized summary of income and transactions

- Ease of understanding for taxpayers
- Facilitates quick comparison with filed returns

Data Reconciliation:

- Taxpayers can compare AIS/TIS data with their records
- Differences can be accepted, modified, or explained
- Improves accuracy in return filing and compliance

TIS and data reconciliation processes promote voluntary compliance and reduce errors in tax reporting.

Impact of Technology on Tax Administration

The integration of AI, analytics, AIS, and TIS has transformed tax administration by:

- Improving transparency and trust
- Reducing manual intervention and bias
- Enhancing efficiency and accuracy
- Supporting data-driven governance

11.7 E-INVOICING AND REAL-TIME REPORTING

E-invoicing and real-time reporting are important digital initiatives introduced under the **Goods and Services Tax (GST)** regime to enhance transparency, improve compliance, and reduce tax evasion. These systems leverage technology to capture transaction details at the time of invoicing, enabling seamless reporting and effective monitoring by tax authorities.

11.7.1. Concept and Framework of E-Invoicing under GST

E-invoicing refers to the electronic generation, authentication, and reporting of invoices in a standardized format prescribed under GST. It does not mean the creation of invoices on a government portal, but rather the **registration and validation of invoices** generated by businesses.

Key Features of the E-Invoicing Framework:

- Applicable to specified categories of taxpayers under GST
- Invoices are generated by businesses using their own accounting or billing software
- Mandatory reporting of invoice details to a central system
- Use of standardized invoice formats for uniformity

The e-invoicing framework ensures consistency in invoice data and facilitates seamless integration with GST returns and e-way bills.

11.7.2. Invoice Registration Portal (IRP)

The **Invoice Registration Portal (IRP)** is a government-designated portal used for validating and registering e-invoices under GST.

Functions of the IRP:

- Receives invoice data from taxpayers
- Validates invoice details as per GST rules
- Generates a unique **Invoice Reference Number (IRN)**
- Digitally signs the invoice
- Generates a **QR code** for verification
- Shares invoice data with GST and e-way bill systems

Once an invoice is registered with the IRP, it becomes a valid e-invoice under GST law.

11.7.3. Real-Time Reporting of Business Transactions

Real-time reporting refers to the transmission of invoice data to tax authorities at the time of invoice generation.

Key Aspects of Real-Time Reporting:

- Immediate availability of transaction data with tax authorities
- Automatic population of GST return details
- Reduction in manual data entry and errors
- Improved tracking of supply of goods and services

Real-time reporting enables continuous monitoring of business transactions and strengthens compliance under GST.

11.7.4. Impact on Transparency, Compliance, and Revenue Collection

E-invoicing and real-time reporting have significantly improved tax governance.

Impact on Transparency:

- Accurate and standardized invoice data
- Reduced scope for fake or duplicate invoices
- Improved traceability of transactions

Impact on Compliance:

- Simplified return filing
- Reduced mismatches in GST returns
- Encouragement of voluntary compliance

Impact on Revenue Collection:

- Reduction in tax evasion and fraud
- Improved detection of non-compliance
- Increased tax base and revenue efficiency

These systems help create a robust, technology-driven taxation framework.

11.8 CHECK YOUR PROGRESS

Q1. What is the main aim of the Digital India Programme in taxation?

Q2. Name two major online taxation portals in India.

Q3. What does PAN stand for?

Q4. Why is TAN important?

Q5. What is the purpose of linking PAN with Aadhaar?

Q6. Mention one benefit of e-filing for taxpayers.

Q7. What is meant by faceless assessment?

Q8. What is AIS in taxation?

Q9. What is the role of the Invoice Registration Portal (IRP) under GST?

Q10. How does real-time reporting improve compliance?

11.9 LET US SUM UP

This unit has comprehensively discussed the transformation of the Indian taxation system under the **Digital India initiative**. It explained how digitisation has modernised tax administration by shifting from manual, paper-based processes to technology-driven, transparent, and efficient systems. The objectives and benefits of digital taxation initiatives were highlighted, emphasizing improved compliance, reduced tax evasion, and enhanced tax governance.

The unit provided an overview of major **online taxation portals** such as the **Income Tax Portal, GSTN, and MCA Portal**, explaining their structure, services, and functionalities. It also highlighted the importance of **integration and data sharing among these portals**, which enables cross-verification, risk profiling, and data-driven decision-making.

The role of **PAN, TAN, and Aadhaar-based systems** was examined as the backbone of taxpayer identification, authentication, monitoring, and control. The importance of PAN–Aadhaar linking in strengthening compliance and preventing misuse of identities was also discussed.

Further, the unit explained **e-filing and digitised assessment concepts**, including electronic filing of returns, benefits of e-filing, faceless assessments, and technology-enabled notices, scrutiny, and appeals. These initiatives have significantly reduced human interface, enhanced transparency, and ensured faster resolution of tax matters.

The unit also highlighted the growing use of **Artificial Intelligence, data analytics, and technology** in tax administration, particularly in risk assessment, profiling, and fraud detection. The concepts and significance of **Annual Information Statement (AIS)** and **Taxpayer Information Summary (TIS)** were explained as important tools for data reconciliation and voluntary compliance.

Finally, the unit discussed **e-invoicing and real-time reporting under GST**, explaining the framework of e-invoicing, the role of the **Invoice Registration Portal (IRP)**, and the impact of real-time reporting on transparency, compliance, and revenue collection.

Overall, this unit demonstrated how technology-driven reforms have strengthened India's tax administration system by improving efficiency, transparency, compliance, and governance, making taxation more taxpayer-friendly and robust.

11.10 ANSWERS TO CHECK YOUR PROGRESS

Answer to Q1: The main aim of the Digital India Programme in taxation is to make tax services available electronically, ensuring transparency, efficiency, and ease of compliance.

Answer to Q2: Two major online taxation portals in India are The Income Tax Portal and the Goods and Services Tax Network (GSTN).

Answer to Q3:PAN stands for Permanent Account Number.

Answer to Q4: TAN is mandatory for filing TDS/TCS returns and ensures proper credit of tax deducted.

Answer to Q5: The purpose of linking PAN with Aadhaar is to eliminate duplicate PANs, ensure accurate taxpayer identification, and prevent tax evasion.

Answer to Q6: One benefit of e-filing for taxpayers is Convenience of filing returns anytime and anywhere.

Answer to Q7: Faceless assessment is a digitized system where tax assessments are conducted electronically without physical interaction between taxpayers and officers.

Answer to Q8: Annual Information Statement – a comprehensive digital record of a taxpayer's financial transactions.

Answer to Q9: The role of the Invoice Registration Portal (IRP) under GST is to validate and register e-invoices, generate Invoice Reference Numbers (IRN), and provide QR codes.

Answer to Q10: Real-time reporting improve compliance by making transaction data immediately available to tax authorities, reducing errors, and simplifying GST return filing.

11.12 FURTHER READING

- Indian Taxation System by Girish Ahuja & Ravi Gupta – Comprehensive coverage of direct and indirect taxes.

- GST in India: Impact and Implications by R.K. Jain – Focused on GST reforms and compliance.

- Income Tax Law & Practice by Dr. Vinod K. Singhania – Widely used for academic and professional exams.

- Chartered Accountant Journal (ICAI) – Professional insights into taxation reforms.
- Economic & Political Weekly (EPW) – Articles on taxation policy and governance.

11.13 MODEL QUESTIONS

Q1. Explain the objectives of Digital India initiatives in taxation. How do they contribute to transparency and efficiency in tax administration?

Q2. Discuss the structure and key functionalities of the Income Tax Portal. How does it simplify compliance for taxpayers?

Q3. What is the role of the Goods and Services Tax Network (GSTN) in India's taxation system? Illustrate its operational framework with examples.

Q4. Differentiate between PAN and TAN. Why are both essential for effective tax compliance?

Q5. Describe the significance of linking PAN with Aadhaar. How does this linkage help in preventing tax evasion?

Q6. What are the benefits of e-filing for taxpayers and tax authorities? Provide at least three advantages for each.

Q7. Explain the concept of faceless assessment. How does it reduce human bias and ensure fairness in tax administration?

Q8. How are Artificial Intelligence and data analytics applied in tax management? Discuss their role in fraud detection and risk profiling.

Q9. What is the Annual Information Statement (AIS)? How does it differ from the Taxpayer Information Summary (TIS), and why are they important for compliance?

Q10. Define e-invoicing under GST. Explain the role of the Invoice Registration Portal (IRP) and the impact of real-time reporting on revenue collection.

UNIT 12: TAXPAYER SERVICES, ETHICS AND RESPONSIBILITIES

UNIT STRUCTURE

12.1Introduction

12.2Rights of taxpayers

12.3Responsibilities of taxpayers

12.4Taxpayer Charter

12.5Grievance redressal mechanisms

12.6Ethical issues in taxation

12.6. 1 How long does it take to resolve

12.6.2. Grievance Redressal Mechanism under the Income Tax Department

12.7Role of tax professionals and consultants

12.8Transparency in tax administration

12.8.1 Role of Tax Professionals

12.8.2 Importance

12.9Accountability in tax administion.

12.10 Citizen-centric tax design.

12.11 Let us sum up

12.12 Check Your Progress.

12.13 Future Reading

12.1 LEARNING OUTCOMES

After completing this unit, learners will be able to:

1. Understand taxpayer services and their role in tax administration.
2. Identify the rights and responsibilities of taxpayers.
3. Explain the Taxpayer Charter and grievance redressal mechanisms.
4. Recognize ethical issues in taxation.
5. Understand the role of tax professionals and consultants.
6. Appreciate transparency, accountability, and citizen-centric tax design.

12.2 INTRODUCTION

A taxpayer is a person or entity who is legally required to pay tax to the government. Taxpayers include individuals, firms, companies, and other organizations earning income or conducting taxable activities. They contribute to government revenue through various taxes such as income tax, GST, and other direct and indirect taxes. Taxes paid by taxpayers are used for public welfare, infrastructure development, and social services. A taxpayer has certain rights to fair treatment and correct information from tax authorities. At the same time, taxpayers have responsibilities to file returns honestly and pay taxes on time. Thus, taxpayers play a vital role in the economic development of a country.

12.3 RIGHTS OF TAXPAYERS

1. Assisting taxpayers in a fair and reasonable manner

Tax authorities are required to assist taxpayers with courtesy and fairness. Taxpayers should receive guidance and support in understanding tax laws and procedures. The department must act in a helpful and non-discriminatory manner.

2. Treating every taxpayer as honest unless proven otherwise

Every taxpayer is presumed to be honest unless there is evidence suggesting non-compliance. Tax authorities should avoid harassment or undue suspicion. This principle promotes trust and voluntary compliance.

3. Providing a fair and impartial procedure and review mechanism

Taxpayers have the right to fair assessment procedures and unbiased decision-making. They can seek review or appeal against incorrect or unjust tax orders. This ensures justice and transparency in tax administration.

4. Providing accurate and complete information regarding tax compliance

Tax authorities must provide correct, updated, and complete information related to tax laws and compliance requirements. Clear communication helps taxpayers meet their obligations properly. This reduces errors and disputes.

5. Deciding tax proceedings in a timely manner

Tax matters such as assessments, appeals, and refunds should be resolved within a reasonable time. Delays cause financial and mental stress to taxpayers. Timely decisions improve efficiency and trust in the tax system.

6. Ensuring collection of the correct amount of tax dues

The tax department should collect only the amount of tax legally due. Excessive or arbitrary tax demands must be avoided. This protects taxpayers from unfair financial burden.

7. Holding tax authorities accountable for their actions

Tax officials are accountable for their decisions and conduct. Any misuse of power or misconduct can be questioned and reviewed. Accountability ensures responsible and ethical behavior by tax officers.

8. Respecting privacy and following due process of law

Taxpayers have the right to privacy during inquiries or investigations. Any examination or search must be conducted strictly according to legal procedures. Arbitrary actions are not permitted.

9. Maintaining confidentiality of taxpayer information

Personal and financial information of taxpayers must be kept confidential. Such information cannot be disclosed unless required by law. This safeguards taxpayer trust and data security.

10. Ensuring accountability for actions of tax officers

The tax administration must ensure that officers are answerable for their conduct. Internal checks, audits, and disciplinary mechanisms exist for this purpose. This strengthens transparency and good governance.

11. Freedom to choose a representative as per tax law

Taxpayers have the right to appoint a tax consultant or authorized representative. This allows professional assistance during assessments and appeals. It ensures fair representation and protection of taxpayer interests.

12.4 RESPONSIBILITIES OF TAXPAYERS

1. Honest disclosure of full information

Taxpayers are expected to be truthful while filing tax returns. They should correctly report all income, expenses, and other required details. Honest disclosure helps avoid penalties and legal issues.

2. Compliance with tax obligations and seeking help if needed

Taxpayers must follow tax laws and complete required formalities such as filing returns and forms. If they face difficulty, they can approach the tax department for guidance. Seeking help ensures correct compliance.

3. Maintaining accurate records

Taxpayers should keep proper records of income, expenses, invoices, and other financial documents. These records help in filing correct returns and during assessments or audits. Maintaining records is a legal requirement.

4. Awareness of actions taken by representatives

If a taxpayer appoints a tax consultant or representative, they should remain informed about the actions taken on their behalf. Responsibility ultimately lies with the taxpayer. Regular monitoring prevents mistakes or misuse.

5. Timely submission of returns and documents

Taxpayers are required to submit tax returns and related documents within the prescribed deadlines. Timely submission avoids late fees, interest, and penalties. It also helps in smooth processing by the tax department.

6. Timely payment of tax dues

Taxpayers must pay the tax amount due within the time limits specified by law. Delayed payment results in interest and penalties. Timely payment supports government revenue and legal compliance.

12.5 TAXPAYER CHARTER

The Taxpayer Charter in India lists the rights and obligations of taxpayers. It has been introduced to build mutual trust between taxpayers and tax authorities and to promote a fair tax system. The charter applies to both taxpayers and tax officers, ensuring transparency and accountability. Although the Taxpayer Charter is a recent initiative, the Central Board of Direct Taxes has earlier issued Citizen's Charters and directed tax officials to follow them strictly.

12.6 TAX PAYER GRIEVANCE REDRESSAL

An income tax grievance refers to a complaint or issue raised by a taxpayer against the Income Tax Department. This may relate to various matters such as incorrect tax assessments, delayed refunds, or other administrative issues. Income tax grievances can be raised through an online grievance portal or by visiting the local income tax office.

Income tax grievances may arise due to incorrect tax assessments, delay in processing refunds, errors in tax return filing requiring rectification, and discrepancies in tax credit such as TDS not reflected in the taxpayer's account. Grievances may also relate to non-grant of eligible tax exemptions, high-pitched or unreasonable assessments, and harassment during search or survey proceedings.

12.6. 1 How long does it take to resolve

- Typically, complaints related to income tax are resolved within 8 weeks from the date they are filed. However, the majority are settled in about one month.

- In cases where the grievance is submitted through the Prime Minister's Office, the Finance Minister's Office, or the Central Board of Direct Taxes, the resolution period is expedited to 21 days.

12.6.2. Grievance Redressal Mechanism under the Income Tax Department

1. The **Central Processing Centre (CPC)** of the Income Tax Department has a dedicated team to handle taxpayer grievances. The grievances are classified based on their nature and are addressed through the following units:
   - **Centralized Processing Centre – Income Tax Return (CPC-ITR)**
     CPC-ITR handles grievances related to income tax returns such as communication delays, incorrect tax demands, discrepancies, verification issues, rectification requests, and refund-related matters.
   - **Centralized Processing Centre – TDS (CPC-TDS)**
     CPC-TDS deals with grievances relating to TDS issues, including discrepancies in Form 26AS, challan corrections, defaults, Forms 16/16A/27D, KYC matters, and registration-related queries.
2. **Directorate of Income Tax (Systems) [DIT (Systems)]**
   DIT (Systems) addresses technical issues in the income tax system, such as assessment-related technical problems, website issues, PAN-related glitches, refund banker (SBI) issues, OLTAS errors, non-filing notices, and other system-related problems.
3. **National Securities Depository Limited (NSDL)**
   NSDL handles PAN-related grievances including Aadhaar–PAN linking, duplicate PAN allotments, digitization errors, discrepancy letters, online application issues, delivery problems, rejections, and upload delays.
4. **Unique Identification Authority of India Infrastructure Technology and Services Limited (UTIITSL)**
   UTIITSL, along with NSDL, manages PAN-related issues such as Aadhaar linking, duplicate PAN allotments, digitization errors, discrepancy letters, online application issues, delivery problems, and rejections.
5. **E-Nivaran Grievance Mechanism**
   E-Nivaran was introduced to resolve taxpayer grievances related to income tax return filing through the e-Filing portal. Grievances are recorded, categorized, and assigned to

CPC officials for timely resolution. The status and resolution are communicated to taxpayers through email and updated in the “My Account” section of the e-Filing portal.

6. **Centralized Public Grievance Redress and Monitoring System (CPGRAMS)**

   CPGRAMS allows taxpayers to submit grievances related to Central and State Government departments. A dedicated CPC team monitors these grievances to ensure timely disposal, and all resolutions are reviewed by a designated Income Tax Department officer before final closure.

7. **Ask Centre – CIT (Helpline) and ITO (TPS) in each Pr. CCIT (Principal Chief Commissioner of Income Tax) Charge-**

   Where ASK (Aaykar Seva Kendra) is Functional

   - When ASK is functional, a computerized system is used to manage taxpayer grievances. The system helps in:
   - Registering taxpayer complaints
   - Giving a unique grievance number to each complaint
   - Sending grievances to the concerned section for action
   - Tracking the progress and status of grievances
   - Because of this system, there is no need to maintain manual records.

8. **CBDT Commitments for Grievance Redressal**

   The CBDT follows certain standards to ensure effective grievance handling:

   - It identifies areas where complaints are common and fixes time limits for resolving them.
   - It provides clear and easy information about how grievances are handled.
   - It makes the grievance redressal process known to the public.
   - Each complaint is recorded properly with all necessary details.
   - Every complaint is examined separately.
   - Complaints are acknowledged quickly with a unique number, expected resolution time, and contact details of the officer concerned.
   - Complaints are investigated carefully and resolved effectively.
   - The final decision is communicated to the taxpayer. If the taxpayer is not satisfied, reasons and alternative remedies are also explained.
   - Ombudsmen are appointed by the Government of India to handle grievances if the normal system does not respond.

9. **Other Grievance Redressal Mechanisms**

   High-Pitched Assessment Committees in each Pr. CCIT(**Principal Chief Commissioner of Income Tax)** charge

   Ask Centre – CIT (Helpline) and ITO (TPS) in each Pr. CCIT charge

   Jurisdictional Assessing Officer (AO)

10. **Online Reputation Management (ORM)**

    The ORM system is used to handle taxpayer grievances raised on social media platforms. These cases are closely monitored by the CBDT and the Income Tax Department. The ORM team assigns cases to the concerned officials to ensure timely and proper resolution.

11. **E-Mail to CPC**

    Taxpayers or their authorized representatives can also raise specific queries by sending emails to the CPC. This helps in resolving grievances quickly through electronic communication.

12.7 ETHICAL ISSUES

Ethical issues in India's taxation system primarily stem from tax evasion, aggressive tax avoidance by corporations, and concerns over the fairness and transparency of the tax administration. These issues create an environment of inequity and can impede national development.

Key Ethical Issues

- **Tax Evasion:** This illegal practice, which involves deliberately underreporting income or falsifying financial information, is a major ethical issue. Common methods include using cash transactions that are harder to trace, hiding money in undeclared offshore accounts, and using fake invoices to inflate expenses.
- **Tax Avoidance & Loopholes:** While technically legal, aggressive tax avoidance (exploiting loopholes in the law to minimize tax liability in a manner inconsistent with the spirit of the law) raises significant ethical concerns. Multinational corporations shifting profits to low-tax jurisdictions (Base Erosion and Profit Shifting - BEPS) and individuals creating complex structures to reduce their tax burden are examples.

- **Corruption and Inefficient Administration:** Perceived corruption within public sector units and inefficient tax authorities can erode public trust and lead citizens to justify their own non-compliance. If taxpayers believe their money is mismanaged, they are less likely to comply voluntarily.
- **Complexity of Tax Laws:** India's complex tax structure, with multiple rates and frequent amendments, creates confusion and provides opportunities for individuals and businesses to find loopholes or make "unintended mistakes," which can be a barrier to ethical compliance.
- **Inequity and Social Justice:** The burden of tax non-compliance disproportionately affects the poor and salaried class, who cannot easily engage in sophisticated tax planning or evasion schemes. Ethical concerns also arise from the taxation of essential items, such as the Goods and Services Tax (GST) on disability aids, which imposes an additional economic burden on vulnerable populations.
- **Lack of Taxpayer Education:** Many taxpayers may not comply not out of a desire to evade, but because they are unfamiliar with the rules and procedures of self-reporting. This lack of awareness contributes to an amoral culture of tax compliance.

12.8 TAX PROFESSIONALS AND CONSULTANTS

Tax professionals and consultants specialize in tax law and financial regulations, offering expert guidance to individuals and businesses to ensure compliance, maximize savings, and provide strategic financial planning.

Their roles are crucial for navigating the complex and ever-changing tax landscape, helping clients avoid errors and penalties.

12.8.1 Role of Tax Professionals-

- **Maximizing Tax Savings through Proper Planning**

  Tax professionals help in effective tax planning to legally reduce tax liability. They advise on investments under sections like 80C, 80D, and capital gains planning. They may also suggest the right timing for selling assets to lower tax payable. Continuous guidance throughout the year leads to better tax savings than last-minute planning.
- **Support in Complex Cases and Tax Audits**

Tax matters become more complicated in cases of multiple income sources, interstate or international transactions, and business operations. Professional guidance ensures proper disclosures and compliance. If a taxpayer is subject to tax audit under Section 44AB, tax consultants help in preparing books of accounts, documents, and audit reports. Their support reduces stress and improves audit readiness.

- **Ensuring Compliance**: Tax laws are complex and constantly changing. Professionals ensure that all filings (local, state, and federal) adhere to current regulations, helping clients avoid penalties, interest charges, and legal issues.
- **Preparing and Filing Returns**: They gather, organize, and accurately complete necessary tax forms and documentation on behalf of clients.
- **Offering Strategic Tax Planning**: Beyond mere compliance, they provide advice to legitimately minimize tax burdens. This involves identifying applicable deductions, credits, and tax-efficient strategies tailored to the client's financial situation.

12.8.2Importance

- **Time-Saving and Error-Free Tax Filing**

  Tax filing requires collection of many financial documents, reconciliation of accounts, and meeting strict deadlines. Doing this without expert help can be time-consuming and may lead to errors, notices, or penalties. Tax consultants handle the entire processfrom paperwork to e-filingsaving time and reducing the risk of mistakes. This allows taxpayers to focus on business or investments.
- **Ethical Standards and Quality Assurance**

  Tax professionals are expected to follow high ethical standards, maintain confidentiality, and provide accurate services. Regulatory bodies like Institute of Chartered Accountants of India set limits and guidelines to ensure audit quality and ethical conduct. Choosing a reputed tax consultant ensures honesty, transparency, and reliable tax compliance.
- **Expertise in Indian Tax Laws and Regulations**

  Indian tax laws are complex and include income tax, GST, TDS, capital gains, and sector-specific rules. These laws change frequently through Finance Acts, circulars, and court judgments. Tax professionals have updated knowledge of these changes and help taxpayers choose the correct ITR form, claim eligible deductions, and apply exemptions properly. This ensures legal compliance and avoids mistakes.

- **Ensuring Proper Registration**: They help self-employed individuals and employers obtain the mandatory Professional Tax Enrolment Certificate (PTEC) or Registration Certificate (PTRC) and ensure timely compliance.
- **Claiming Income Tax Deduction**: They ensure that the professional tax paid is correctly claimed as a deduction under Section 16(iii) of the Income Tax Act, which reduces the overall income tax liability (applicable under the old tax regime).

12.9 TRANSPARENCY AND ACCOUNTABILITY IN TAX ADMINISTRATION

Transparency and accountability in tax administration are fundamental principles of good governance, essential for building public trust, ensuring fair and effective revenue collection, and facilitating sustainable national development. These principles are implemented through clear information sharing, defined responsibilities, and robust oversight mechanisms.

Transparency in Tax Administration

1. Clear tax laws and rules

Tax laws and procedures should be simple and clearly explained so that taxpayers understand their duties. Clear rules reduce confusion and help in voluntary compliance.

2. Open communication

Tax authorities should provide correct and timely information through notices, websites, and help centres. Proper communication builds trust between taxpayers and the department.

3. Online systems and digitisation

Facilities like e-filing, online payments, and digital portals make tax processes open and traceable. Digitisation reduces personal interaction and chances of corruption.

4. Reasoned decisions

Tax officers must clearly explain the reasons for assessments and tax orders. This helps taxpayers understand decisions and reduces disputes.

5. Access to information

Taxpayers should be able to easily check the status of returns, refunds, and grievances. Easy access to information increases transparency in the tax system.

Accountability in Tax Administration-

1. Responsibility of tax officers

Tax officers are responsible for their actions and decisions. They must act fairly and according to tax laws.

2. Time-bound services

Services like refunds, assessments, and grievance redressal should be completed within fixed time limits. This prevents unnecessary delays and hardship.

3. Review and appeal mechanisms

Taxpayers can challenge incorrect or unfair decisions through appeal and review processes. This ensures justice and fairness.

4. Disciplinary action for misconduct

Strict action is taken against officers involved in corruption or misuse of power. This discourages unethical behaviour.

5. Performance monitoring

The work of tax officers is regularly reviewed and monitored. This helps maintain efficiency, fairness, and accountability.

12.10 CITIZEN-CENTRIC TAX DESIGN IN INDIA

Citizen-centric tax design in India refers to a taxation system that places taxpayers at the centre of tax administration. The objective is to make tax laws and procedures simple, transparent, and user-friendly, rather than complex and intimidating. In recent years, India has shifted from a control-based approach to a service-oriented and trust-based tax system. Digital initiatives such as e-filing, online payments, and faceless assessments have reduced direct interaction between taxpayers and tax officials. The introduction of the Taxpayer Charter, grievance redressal mechanisms, and time-bound services further strengthen taxpayer confidence. A citizen-centric approach also emphasizes fairness, accountability, and respect for taxpayer rights. Overall, this

model aims to encourage voluntary compliance, reduce disputes, and build long-term trust between citizens and the tax administration.

1. Simplicity of tax laws and procedures

The Indian tax system aims to simplify laws, forms, and procedures so that taxpayers can easily understand and comply without confusion.

2. Digital and online services

Facilities like e-filing of returns, online tax payment, pre-filled returns, and online grievance redressal reduce physical visits and save time.

3. Faceless and paperless administration

Faceless assessment and appeals reduce personal interaction between taxpayers and officials, ensuring fairness and minimizing harassment.

4. Timely services and quick refunds

A citizen-centric approach ensures faster processing of returns, timely refunds, and quick resolution of grievances.

5. Transparency and trust-based system

Taxpayers are treated as honest by default, and decisions are communicated with proper reasons. This builds trust and encourages voluntary compliance.

6. Taxpayer education and assistance

Awareness programs, help centres, and online guidance are provided to educate taxpayers about their rights, duties, and procedures.

CHECK YOUR PROGRESS

A. Fill in the Blanks

1. The Taxpayer Charter aims to build _____ between taxpayers and tax authorities.
2. Every taxpayer is treated as _____ unless proven otherwise by the tax department.
3. CPC-ITR mainly handles grievances related to _____ and refunds.

4. CPGRAMS allows citizens to submit grievances related to _____ departments.
5. Citizen-centric tax design focuses on _____ and voluntary compliance.

B. Short Answer Questions

1. Who is a taxpayer?
2. What is meant by the Taxpayer Charter?
3. What is CPC-TDS?
4. State any two rights of taxpayers.
5. What is meant by citizen-centric tax design?

12.11 LET US SUM UP

- Taxpayers are the foundation of government revenue, and their contributions support public welfare, infrastructure, and national development.
- A balanced tax system requires both strong taxpayer rights (fair treatment, privacy, transparency, accountability) and clear taxpayer responsibilities (honest disclosure, timely filing, record-keeping, and payment of dues).
- The Taxpayer Charter has strengthened trust by clearly defining the duties of tax authorities and protecting taxpayers from arbitrary actions.
- Ethical challenges such as tax evasion, aggressive avoidance, corruption, complexity, and inequity continue to affect compliance and public confidence, highlighting the need for fairness, education, and strong governance.
- Tax professionals and consultants play a crucial role in ensuring legal compliance, reducing errors, supporting audits, enabling tax planning, and maintaining ethical standards.
- The shift towards digital and transparent tax administrationthrough e-filing, GSTN, faceless assessments, AI-based analytics, and data integrationhas improved efficiency, accuracy, and integrity in tax operations.
- Transparency (clear laws, open communication, digitization, reasoned orders) and accountability (time-bound services, appeal systems, disciplinary action, performance monitoring) are now central to modern tax governance.

- India’s move toward a citizen-centric, trust-based tax systemsupported by simplified procedures, online services, fast refunds, and taxpayer educationhas enhanced voluntary compliance and ease of doing business.
- Overall, the Indian tax system is evolving from a control-oriented framework to a service-driven, ethical, and technology-enabled model, promoting fairness, compliance, and sustainable economic growth.

12.12 ANSWERS TO CHECK YOUR PROGRESS

Answer to Fill in the blanks

1. **Trust**
2. **Honest**
3. **Returns**
4. **Government**
5. **Convenience**

Answer to short questions

1. Taxpayer: A taxpayer is a person or entity who is legally liable to pay tax to the government.
2. Taxpayer Charter:The Taxpayer Charter is a document that defines the rights, responsibilities, and expectations of taxpayers and the tax department to ensure fair and transparent tax administration.
3. CPC-TDS:CPC-TDS (Centralized Processing Cell for Tax Deducted at Source) is a system that processes TDS returns and ensures proper credit of TDS to taxpayers.
4. Any two rights of taxpayers:
    - Right to fair and respectful treatment
    - Right to timely service and grievance redressal

5. Citizen-centric tax design: Citizen-centric tax design means designing tax policies and systems that are simple, transparent, and focused on the convenience and needs of taxpayers.

12.13 MODEL QUESTIONS

1. Explain the rights and responsibilities of taxpayers in India.
2. Discuss the Taxpayer Charter and its significance in the Indian tax system.
3. Explain the grievance redressal mechanism under the Income Tax Department.
4. Describe the role of CPC-ITR, CPC-TDS, and DIT (Systems) in grievance handling.
5. Discuss the ethical issues in taxation and their impact on taxpayers and tax administration.
6. Explain the role and importance of tax professionals and consultants in ensuring tax compliance.
7. Discuss transparency and accountability in tax administration with suitable examples.
8. Explain the concept of citizen-centric tax design in India and its key features.

12.14 FURTHER READING

1. Government of India. (2020). *Taxpayer's Charter*. Central Board of Direct Taxes (CBDT),Ministry of Finance.
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UNIT 13: INTERNATIONAL TAXATION – BASICS (WITHOUT COMPUTATION OR LEGAL RULES)

UNIT STRUCTURE

13.1 Learning Objectives

13.2 Introduction to International Taxation

13.3 Concept of International Taxation

13.4 Double Taxation: Meaning and Relevance

13.5 Double Taxation Avoidance Agreements (DTAA): Overview and Purpose

13.6 Role of OECD and BEPS Initiative (Conceptual Understanding)

13.7 Transfer Pricing – Conceptual Overview

13.8 Global Trends in Taxation and Their Influence on India

13.9 Let Us Sum Up

13.10 Further Readings

13.11 Model Questions

13.1 LEARNING OBJECTIVES

After studying this unit, the learner will be able to:

- Understand international taxation and its importance.
- Explain the meaning and relevance of double taxation
- Recognize the goal and general structure of Double Taxation Avoidance Agreements (DTAA)
- Explain the function of global institutions like the BEPS project and the OECD.

- Understand the concept of transfer pricing at a basic level
- Determine international tax trends and how they affect the Indian tax system.

13.2 INTRODUCTION TO INTERNATIONAL TAXATION

The term "international taxation" refers to the collection of rules, procedures, and systems that govern how nations tax assets, income, or cross-border transactions. Growing globalization often results in businesses and individuals making money in numerous nations. Complicated tax concerns result from the fact that every country has its own tax laws and regulations. The primary objective of international taxes is to ascertain if and to what extent nations have the power to tax a certain revenue. Generally speaking, countries either use the source-based notion (taxing income where it is produced) or the resident-based approach (taxing income based on the taxpayer's domicile). In actuality, most countries blend the two concepts.
International taxation is essential for:
• Encouraging international economic cooperation;
• Preventing tax evasion and avoidance;
• Facilitating international investment and commerce; and
• Ensuring equity in the allocation of taxation rights

International taxes are becoming increasingly important for a country like India because of the rise in foreign investments, the growth of multinational enterprises (MNEs), employment overseas, and digital cross-border operations.

13.3 CONCEPT OF INTERNATIONAL TAXATION

With increasing globalization, businesses and individuals often earn income in more than one country. This creates complex taxation situations involving multiple jurisdictions, each having its own tax laws and policies.

The primary goal of international taxation is to establish which countries have the authority to tax a specific income and to what extent. Countries often use either the source-based concept (taxing income where it is generated) or the residence-based approach (taxing income based on the taxpayer's residence). In practice, most countries combine both concepts.

International taxation plays a crucial role in:

- Facilitating cross-border trade and investment
- Preventing tax evasion and avoidance
- Ensuring fairness in the allocation of taxing rights
- Promoting economic cooperation between countries

International taxes are becoming increasingly relevant in India as a result of expanding foreign investment, the expansion of multinational businesses (MNEs), overseas employment, and digital cross-border activities.

13.4 DOUBLE TAXATION: MEANING AND RELEVANCE

13.4.1 Meaning of Double Taxation

When the same income, profit, or financial gain is subject to taxation in multiple countries, it is referred to as "double taxation". When people or companies conduct business internationally, this problem usually arises. Because it discourages international trade and investment while imposing an excessive burden on taxpayers, the issue is considered one of the most significant challenges in international taxation.

Double taxation is often caused by the differing concepts used by countries in determining tax liability:

• Residence-based taxation: Certain governments impose taxes on citizens according to their global income. For instance, India taxes its citizens' worldwide income under the Income Tax Act.

• Source-based taxation: Some nations impose taxes on income earned inside their borders, irrespective of the residence of the taxpayer. For instance, India taxes income at the source if a foreign company receives royalties from the country.

The same income may be subject to two taxes when both principles are applied concurrently.

For example, Let's say a customer in the US pays consulting fees to an Indian resident.

• Since this revenue is generated inside US borders, the US may tax it (source principle).

• Because the consultant resides in India (residence principle), India may also tax the same income. As a result, the consultant's earnings are subject to double taxation.

Types of Double Taxation:

1. When a taxpayer is taxed twice for the same income by two different nations, this is known as jurisdictional double taxation.
2. Taxing the same income by two distinct taxpayers is known as "economic double taxation." For instance, corporate profits are subject to taxation both at the company level and when they are distributed to shareholders as dividends.

Relevance in International Taxation:

- Double taxation increases the cost of doing business internationally, impedes investment, cross-border trade, and professional mobility, and creates uncertainty for both people and multinational corporations that operate abroad.
- Governments enter into Double Taxation Avoidance Agreements (DTAAs), which offer relief by crediting taxes paid overseas or exempting income in one nation, in order to address this problem.

13.4.2 Relevance of Double Taxation

One of the biggest problems with international tax law is the problem of double taxation. It happens when the same income is subject to taxation in several different countries, typically as a result of overlapping residence-based and source-based taxation claims. Understanding this phenomenon is essential to comprehending global tax systems since it has significant implications for governments, corporations, and taxpayers.

Double taxation is considered a major concern for several reasons:

- **Increases tax burden for taxpayers:**When revenue is taxed twice, it places an undue financial burden on both individuals and corporations. A professional who works abroad, for example, may be required to pay taxes in both their home nation and the country where they are employed. In a similar vein, different tax rates may make multinational corporations less profitable and competitive.

- **Discourages Cross-border Trade and Investment:**If companies and investors worry about paying double taxes on their revenues, they are usually hesitant to grow globally. By deterring foreign direct investment (FDI) and international trade, this slows economic growth and diminishes chances for global cooperation.

- **Creates uncertainty and complexity:**It is difficult for taxpayers to ascertain their actual tax burden when multiple nations claim taxing rights over the same revenue. This uncertainty hinders financial planning and compliance, and the complexity of many tax laws increases administrative expenses for enterprises.
- **Acts as an obstacle to global economic integration:**In this age of globalization, the smooth movement of cash, products, and services is crucial. However, double taxation creates a barrier by splitting international markets. It goes against the notion of free trade and prevents countries from fully utilizing global economic cooperation.

To mitigate these challenges, countries adopt various measures such as:

- **Bilateral Agreements (DTAAs):** Nations frequently enter into Double Taxation Avoidance Agreements (DTAAs) to prevent the same income from being taxed twice—once in the country where it is earned (source country) and again in the country of residence. These agreements clearly define which country has the right to tax specific types of income, such as dividends, royalties, or business profits. For example, if a company based in India earns income in Germany, the DTAA between the two countries ensures that taxation rights are fairly distributed, reducing the burden on taxpayers and encouraging cross-border trade and investment.
- **International Standards and Guidelines:** Global organizations like the Organisation for Economic Co-operation and Development (OECD) play a crucial role in promoting fairness and consistency in international taxation. The OECD provides model tax treaties

and frameworks, such as the OECD Model Tax Convention, which serve as references for countries when drafting their own agreements. These standards encourage transparency, reduce tax evasion, and foster cooperation among nations, making the global tax environment more predictable and equitable.

- **Domestic Relief Measures:** In addition to international agreements, many countries provide relief at the domestic level. Taxpayers may be allowed to claim a foreign tax credit, which offsets taxes paid abroad against domestic tax liability. Alternatively, some jurisdictions exempt certain categories of foreign income from local taxation altogether. For instance, a resident taxpayer who pays taxes on income earned overseas may either receive a credit for those taxes or be exempted from paying additional taxes at home, depending on the country's policy. These measures ensure that individuals and businesses are not unfairly penalized for engaging in international economic activities.

Double taxation is significant because it has a huge impact on both individual taxpayers and international trade. Fostering cross-border economic activity, guaranteeing tax justice, and advancing long-term global integration all depend on addressing this issue through treaties, international cooperation, and home reforms.

13.5 DOUBLE TAXATION AVOIDANCE AGREEMENTS (DTAA): OVERVIEW AND PURPOSE

13.5.1 Overview of DTAA

A Double Taxation Avoidance Agreement (DTAA) is a bilateral treaty that aims to provide clarity and relief in cases when income is taxed in more than one jurisdiction. These agreements set a framework for how countries share taxation rights, how taxpayers can seek relief, and how tax authorities collaborate with one another. DTAAs contribute significantly to the facilitation of international trade, investment, and professional mobility.

The key features of DTAA can be summarized as follows:

- **Rules to Determine Taxation Rights** DTAAs establish explicit procedures for determining which country has the authority to tax specific types of income, including as salaries, dividends, royalties, interest, and capital gains. For example, under many

treaties, employment income is taxed in the nation where the job is done, although dividends may be taxed in both the source and residence countries, with reduced rates. This allotment of taxing powers avoids arguments and maintains justice.

- **Relief Mechanisms (Tax Credit or Exemption)** To avoid double taxation, DTAAs provide relief through mechanisms such as:
    - **Exemption Method**: Income is taxed only in one country, and exempted in the other.
    - **Credit Method**: Tax paid in the source country is credited against tax liability in the residence country. These methods ensure that taxpayers are not penalized for engaging in cross-border activities.
- **Exchange of Information Between Tax Authorities** Modern DTAAs feature mechanisms for exchanging information between tax administrations. This enables countries to detect tax evasion, monitor global corporations, and enforce compliance. For example, India's treaties provide for the automatic transmission of information on income earned by residents overseas, thereby increasing openness and accountability.
- **Mutual Cooperation to Resolve Tax Disputes** DTAAs provide mechanisms like the Mutual Agreement Procedure (MAP), which allows both countries' tax agencies to settle problems peacefully. This is especially relevant in circumstances requiring transfer price adjustments or differing interpretations of treaty requirements. MAP ensures that taxpayers are not embroiled in protracted litigation and that conflicts are resolved properly.

India has signed DTAAs with a number of countries, including the US, UK, Singapore, Germany, and Mauritius. These agreements have helped to encourage cross-border economic activities by lowering tax barriers, increasing foreign direct investment (FDI), and providing certainty to businesses and individuals.

13.5.2 Purpose of DTAA

A Double Taxation Avoidance Agreement (DTAA) is a formal bilateral treaty between two countries that guarantees that the same income is not taxed twice in different jurisdictions. These agreements are essential to international taxation because they give taxpayers with certainty and relief when conducting cross-border transactions. DTAAs promote economic

cooperation and lower barriers to global commerce and investment by aligning both countries' taxation rights.

The primary purposes of DTAA can be explained as follows:

- **Avoidance of Double Taxation**The primary goal of DTAA is to eliminate or minimize the occurrence of double taxation. Individuals and corporations generating income overseas may be taxed in both their home nation and their source country if no such agreements are in place. To maintain fairness, DTAAs include mechanisms such as the exemption method (income is taxed only once) and the credit method (tax paid overseas is credited against local tax burden).
- **Promotion of International Trade and Investment**DTAAs support foreign corporate expansion by lowering taxes and clarifying tax duties. Investors are more likely to engage in cross-border commerce and investment if they know their profits will not be diminished by numerous levels of taxation. For example, India's DTAA with Singapore has played an important role in attracting foreign direct investment (FDI) from Singaporean enterprises.
- **Allocation of Taxing Rights Between Countries**DTAAs explicitly state which country has the authority to tax various types of income, such as dividends, royalties, interest, and capital gains. This distribution prevents international disputes and guarantees that taxation is proportional to economic activity. For example, under many treaties, royalties may be taxed at a lower rate in the source country, while the residence country retains the ability to tax global income.
- **Prevention of Tax Evasion**DTAAs aim not just to avoid double taxation, but also to prevent tax evasion. They include provisions for information exchange between tax authorities, which allows governments to detect and combat activities such as profit shifting, the use of shell firms, and income hiding. This promotes worldwide collaboration and transparency in taxation.
- **Providing Certainty to Taxpayers**One of the most essential features of DTAA is the assurance it provides to taxpayers. Individuals and organizations can plan their finances and investments with certainty because they understand how their revenue will be taxed. This decreases litigation, administrative costs, and compliance demands, resulting in a more stable environment for international business.

13.6 ROLE OF OECD AND BEPS INITIATIVE (CONCEPTUAL UNDERSTANDING)

13.6.1 Role of OECD

The **Organization for Economic Co-operation and Development (OECD)** is a global intergovernmental body that works to foster economic growth, stability, and cooperation among its member and partner countries. Established in 1961, the OECD has gradually evolved into a key institution that not only addresses economic development but also provides leadership in shaping international tax norms. Its influence extends well beyond its 38-member nations, as many non-member countries also adopt OECD recommendations and frameworks.

In the field of taxation, the OECD performs several critical functions:

- **Development of International Tax Standards and Guidelines**: The OECD develops globally acknowledged principles and standards that help countries establish fair and efficient tax systems. These guidelines assist to decrease anomalies in national tax legislation and guarantee that multinational corporations are taxed in a way that reflects their actual economic operations.
- **Provision of a Model Tax Convention**: One of the OECD's most significant achievements is its Model Tax Convention on Income and Capital. This paper serves as a template for governments negotiating bilateral tax treaties. It clarifies topics such as residence, source of income, and how to prevent double taxation. This paradigm influences several of India's Double Taxation Avoidance Agreements.
- **Promotion of Transparency and Cooperation Among Tax Administrations**: The OECD encourages countries to share tax-related information and implement measures to minimize tax evasion and aggressive tax avoidance. The OECD has expanded worldwide collaboration and boosted tax authorities' abilities to oversee multinational firms through initiatives such as Automatic Information Exchange and Country-by-Country Reporting.

Overall, the OECD plays an important role in defining worldwide tax policies. Its initiatives, particularly the Base Erosion and Profit Shifting (BEPS) Project, have changed how governments approach international taxation. By fostering fairness, openness, and cooperation,

the OECD guarantees that taxation systems stay relevant in an age of globalization and digital economies.

13.6.2 BEPS Initiative – Concept

Base Erosion and Profit Shifting (BEPS) are tax planning tactics used by multinational corporations (MNEs) to exploit gaps and mismatches in international tax legislation. These tactics enable businesses to artificially move profits from high-tax jurisdictions to those with little or no taxation, weakening the tax base in the country where the actual economic activity occurs. Such actions lower government income, disrupt competitiveness, and jeopardize the integrity of global tax systems.

Recognizing the gravity of the situation, the Organization for Economic Cooperation and Development (OECD), in partnership with the G20 countries, created the BEPS Initiative in 2013. This program represents significant global efforts to reform international taxation and guarantee that earnings are taxed where meaningful economic activity occurs and value is created.

The BEPS Initiative aims to achieve the following objectives:

- **Prevent Artificial Shifting of Profits**Multinational firms frequently employ complicated arrangements, such as shell companies or intra-group transactions, to shift earnings to tax haven countries. The BEPS framework aims to reduce these abuses by tightening regulations governing transfer pricing, treaty abuse, and hybrid mismatches.
- **Ensure Taxation Where Economic Activities Take Place**The core idea of BEPS is that taxation should be consistent with value creation. For example, if a corporation generates revenue from Indian consumers, it should pay a fair proportion of taxes in India, even if its headquarters are overseas.
- **Improve Transparency and Fairness in International Taxation**BEPS encourages increased transparency by forcing multinational corporations to disclose Country-by-Country Reporting (CbCR), which includes details on profits, revenues, and taxes paid in each jurisdiction. This increases transparency and allows tax authorities to identify aggressive tax planning.

In essence, BEPS seeks to address loopholes in international tax laws and foster global collaboration. It introduced 15 Action Plans that addressed concerns such as treaty breaches, abusive tax tactics, transfer pricing paperwork, and digital economy taxation. These policies seek to restore faith in tax systems, level the playing field, and guarantee that governments can collect the revenue necessary to provide public services.

The BEPS Initiative has had a considerable influence on countries such as India, which has adopted several BEPS suggestions into its legislation, including General Anti-Avoidance Rules (GAAR), stricter transfer pricing controls, and tax policies for the digital economy. India's integration with BEPS strengthens its ability to combat tax evasion and ensures that its tax system is robust in the face of globalization.

13.7 TRANSFER PRICING – CONCEPTUAL OVERVIEW

Transfer pricing pertains to the establishment of prices for goods, services, or intangible assets that are transacted between affiliated entities within a multinational enterprise (MNE) operating across various countries**.** Since these entities are interconnected, the pricing of such transactions can directly influence the allocation of profits among different jurisdictions.

Key Concepts of Transfer Pricing:

 Transactions between related businesses When two or more businesses with shared ownership or control conduct cross-border transactions, transfer pricing is applicable. These could include finished products, raw materials, services, or intellectual property licensing.

 Influence on profit allocation among countries. The pricing used in these transactions decide how much profit is recorded in each country. For example, if a company in a low-tax country charges higher prices than a subsidiary in a high-tax country, the low-tax jurisdiction receives more profit.

 Risk of manipulation to lower tax liability. Because MNEs may determine internal pricing, there is a possibility that they will manipulate transfer prices to reduce total tax liabilities. This

approach has the potential to weaken the tax base of high-tax countries, resulting in unfair competition.

The primary purpose of transfer pricing laws is to guarantee fair taxes by mandating that transactions between related parties adhere to the arm's length concept. This idea suggests that pricing should be comparable to those paid by independent, unrelated businesses under identical conditions.

By enforcing this principle:

- Governments can prevent artificial shifting of profits.
- Tax revenues are protected across jurisdictions.
- Multinational enterprises are encouraged to maintain transparency and fairness in their global operations.

(This unit discusses transfer pricing only at a **conceptual level**, without methods or calculations.)

13.8 GLOBAL TRENDS IN TAXATION AND THEIR INFLUENCE ON INDIA

Global taxation refers to the systems and rules that govern how countries tax cross-border economic activities. In recent years, taxation has been undergoing rapid transformation due to several interconnected factors:

- **Digitalization of the economy:**The digital economy has challenged established tax standards meant for tangible items and local enterprises. Governments are now tasked with taxing value generated in digital contexts where physical presence is negligible.
- **Growth of multinational enterprises (MNEs):**Multinational companies (MNEs) expand globally, transferring earnings and resources between subsidiaries. This development has made it more difficult for individual nations to collect fair tax revenues, spurring proposals for coordinated worldwide tax regimes.

- **Increased international cooperation:**International cooperation: Organizations such as the OECD and G20 collaborate to set uniform taxation rules. This collaboration serves to avoid damaging tax competition while also ensuring that earnings are taxed where economic activity occurs.
- **Focus on transparency and information exchange:**Tax authorities throughout the world are promoting transparency and data exchange. Initiatives like the automated sharing of financial information seek to prevent tax evasion and assure accountability.

Key Global Trends:

- **Greater use of data and technology in tax administration:**Tax authorities are using sophisticated analytics, artificial intelligence, and digital technologies to improve compliance, identify fraud, and simplify tax collection.
- **Global minimum tax initiatives:**The OECD's Base Erosion and Profit Shifting (BEPS) initiative, as well as the G20's adoption of a worldwide minimum corporation tax, attempt to prevent profits from migrating to low-tax nations. This assures that multinational firms pay their fair share of taxes, no matter where they operate.
- **Increased focus on taxing digital businesses:**Special frameworks are being devised to tax digital giants that produce considerable revenue in nations with no physical presence. This includes levies on digital services and new profit-allocation procedures.
- **International cooperation against tax avoidance:**Countries are working together to remove loopholes, unify tax regulations, and increase enforcement against aggressive tax planning tactics. This collaborative effort limits chances for firms to exploit differences across national tax regimes.

INFLUENCE OF GLOBAL TRENDS IN THE TAX SYSTEM ON INDIA:

Global tax trends have had a significant influence on India’s taxation system, pushing it toward greater transparency, digitalization, and alignment with international standards. The global movement against Base Erosion and Profit Shifting (BEPS) has encouraged India to strengthen its anti-avoidance measures, such as the introduction of General Anti-Avoidance Rules (GAAR) and stricter transfer pricing regulations, ensuring that multinational corporations cannot easily shift profits to low-tax jurisdictions. Similarly, the OECD’s proposal for a global minimum

corporate tax has implications for India, as it helps secure fair taxation of multinational companies operating within the country, while also requiring India to balance competitiveness with compliance to global norms. Another major trend is the taxation of the digital economy, where India has taken proactive steps by introducing the Equalisation Levy on foreign digital services and enhancing compliance through platforms like GSTN and e-invoicing, aligning with global efforts to fairly tax digital giants. Sustainability and green taxation are also emerging as global priorities, with many countries adopting carbon taxes and eco-levies. India is exploring similar measures, such as adjusting excise duties on fossil fuels and incentivizing renewable energy, to support climate goals while generating revenue. In addition, the worldwide adoption of advanced technologies in tax administration—such as artificial intelligence, big data, and blockchain—has influenced India to modernize its own systems. Initiatives like faceless assessments, AI-driven fraud detection, and the use of Annual Information Statements (AIS) and Taxpayer Information Summaries (TIS) reflect this shift, making tax compliance more efficient and transparent.

India is rapidly incorporating global norms into its tax policy, and by using worldwide best practices, the country has modernized its tax administration, strengthened compliance systems, and increased cross-border transaction monitoring efficiency, ensuring competitiveness and credibility in the global economic context. India has aligned its international taxation framework with the OECD's BEPS project, reflecting its commitment to the arm's length principle and fair allocation of profits, while also strengthening its ability to address challenges posed by digitalization and profit shifting by multinational enterprises. To safeguard its revenue base, India has reinforced transfer pricing laws, introducing mechanisms such as Advance Pricing Agreements (APAs) and Safe Harbour Rules, which provide transparency and reduce disputes between authorities and taxpayers. By ensuring that related-party transactions are priced appropriately, this framework minimizes manipulation risks. India also actively participates in international tax debates facilitated by the G20 and OECD, with proactive engagement in initiatives such as the global minimum tax and frameworks for taxing digital firms. This involvement ensures that India's policies remain current and aligned with worldwide trends. Overall, global tax reforms are nudging India to modernize its tax framework by making it more digital, eco-friendly, and globally integrated. While these changes strengthen compliance and revenue collection, India faces challenges in balancing global obligations with domestic interests, maintaining competitiveness, and building the technological infrastructure needed to support advanced tax systems.

13.9 LET US SUM UP

In an easily understood and conceptual way, this course introduced the fundamental ideas of international taxes. The problem of double taxation, the significance of international taxes, and the function of Double Taxation Avoidance Agreements were all explained. The unit also covered the fundamentals of transfer pricing, the role of the OECD and the BEPS program, and new developments in international taxes. Learners may better comprehend how nations work together to handle cross-border taxation in a globalized economy by grasping these ideas.

13.10 FURTHER READING

- OECD – International Taxation and BEPS (Introductory publications)
- Government of India – Income Tax Department (International Taxation overview)
- Basic textbooks on International Taxation and Global Finance

13.11 MODEL QUESTIONS

1. Explain the concept of international taxation.
2. What is double taxation? Why is it a concern in international trade?
3. Discuss the purpose of Double Taxation Avoidance Agreements (DTAA).
4. Explain the role of OECD in international taxation.
5. What is the BEPS initiative?
6. Explain the concept of transfer pricing.
7. Discuss global trends in taxation and their impact on India.

UNIT 14: CONTEMPORARY ISSUES AND TRENDS IN INDIAN TAXATION

UNIT STRUCTURE

14.1 Learning Objectives
14.2 Introduction
14.3 Impact 0f GST Reforms and Changes
14.4 Faceless Assessment and Digital Compliance
14.5 Taxation of The Digital Economy
14.6 Environmental Taxation and Green Initiatives
14.7 Informal Sector and Taxation Challenges
14.8 Future Directions of India's Tax System
14.9Let Us Sum Up
14.10Further Readings
14.11Answers to Check Your Progress
14.12Model Questions

14.1 LEARNING OBJECTIVES

After studying this unit, the learner will be able to:

- Describe the major impacts of recent GST reforms and changes on taxpayers and governments.
- Explain the idea and working of faceless assessment and wider digital tax compliance in India.
- Identify key challenges in taxing the digital economy and ongoing policy responses.
- Discuss the role of environmental or green taxes such as carbon related cesses and green initiatives in India.
- Analyse taxation issues linked to the informal sector and outline possible future directions for India's tax system.

14.2 INTRODUCTION

Indian taxation is going through a fast period of change. Earlier the focus was mainly on rates and basic structures of direct and indirect taxes. Now the focus has moved towards simplification, technology-based administration, better coverage of new business models and using taxes as tools to support wider goals such as environmental protection and formalization of the economy.

Some key reforms include the introduction and continuous fine tuning of Goods and Services Tax, the move to faceless assessment and e compliance in direct and indirect taxes, and new rules to tax the digital economy and cross border digital services. At the same time, India has started using or debating green taxes such as cesses on coal and vehicle-based levies while still facing serious challenges in taxing the large informal sector where many activities remain outside the formal tax net. This unit looks at these contemporary issues and considers how they shape the direction of India's tax system in the coming years.

14.3 IMPACT OF GST REFORMS AND CHANGES

Goods and Services Tax was rolled out in 2017 as a major reform that merged many central and state indirect taxes into a single system. The main aim was to create a common national market, reduce cascading of taxes and make compliance simpler with one framework instead of many separate laws. Over time GST rules, rates and procedures have been adjusted through council decisions, notifications and annual budgets to deal with practical problems and fill gaps.

One clear impact has been on the investment climate. Investor facing agencies note that GST, along with other tax reforms, has helped make India more predictable for businesses by providing uniform rules across states and clearer credit chains. Input tax credit has allowed businesses to offset tax paid on inputs against output tax, which reduces the final tax cost if the credit chain works smoothly. However, frequent rate changes, classification disputes and technical glitches in return filing have also created compliance burdens, especially for small enterprises.

Another important change is the increasing use of data and analytics in GST administration. E way bills, e invoicing and online return matching give authorities large datasets to detect mismatches and fake credits. This has improved the ability to spot evasion but has also raised concerns about the capacity of small taxpayers to cope with digital systems and the need for stable IT infrastructure. Overall, GST continues to be a work in progress, with ongoing reforms

aimed at rationalizing rate slabs, simplifying returns and strengthening the technology backbone.

Impact of GST Reforms and Changes

Change / Reform	Impact on the System	Explanation
One Nation, One Tax	**Unified Market**	Before GST, there were many different taxes. GST replaced them to create a single, uniform tax system across India.
Removal of Multiple Taxes	**Subsuming Old Taxes**	GST combined (subsumed) many old taxes like Central Excise, Service Tax, State VAT, Entry Tax, Luxury Tax, and Octroi into one single tax.
Elimination of "Domino Effect"	**No Tax on Tax**	The old system had a "cascading effect" or domino impact where tax was charged on top of tax. GST fixed this problem, making the process smoother.
New Power Structure	**Dual Control**	Previously, Centre and States had separate powers. Now, under **Article 246A**, both the Centre and States have the power to tax the same transaction simultaneously.
GST Council (Article 279A)	**Joint Decision Making**	A new body called the GST Council was created. It includes Ministers from both the Centre and States to decide tax rates and rules together, ensuring harmony.
Inter-State Trade (IGST)	**Better Regulation**	For trade *between* states, the Centre collects **IGST** (Integrated GST). This money is then shared between the Centre and the States, preventing confusion on who collects what.
Revenue Distribution	**Sharing Funds**	The Constitution was changed (Article 270) to ensure that the tax money collected by the Union from GST is fairly distributed between the Centre and the States.
Streamlined	**Efficiency**	The introduction of GST made the tax system more

Process		streamlined and less complicated compared to the old system which was considered poor and confusing.
Long-Term Growth	**Increased Revenue**	The clarity and uniformity brought by GST are expected to lead to an increase in government revenues in the long run.

14.4 FACELESS ASSESSMENT AND DIGITAL COMPLIANCE

India has taken major steps to move from paper based, face to face tax administration towards digital, contactless systems. In direct taxes, the faceless e assessment scheme under the Income Tax Act marks a big shift from traditional assessment that depended on personal meetings between taxpayers and local officers.

Under the faceless system, assessments are carried out through a central National e Assessment Centre and a network of assessment, verification, technical and review units. Cases are selected and distributed electronically, notices are sent through the online portal and email, and replies are filed digitally. Taxpayers do not know which officer is handling their case and there is usually no physical appearance, except in limited situations where video hearings may be allowed.

The main goals are to increase transparency, reduce discretion and scope for corruption, and bring uniformity in decision making by using standard procedures and risk-based allocation. Early reports note that thousands of cases have been completed under faceless assessment without major additional demands, which suggests that the system can work efficiently when supported by adequate technology and training.

A similar vision is now being applied to indirect taxes like customs and GST. Faceless customs assessment groups examine import documents irrespective of the port of entry. Under GST, authorities are moving towards faceless adjudication, scrutiny and appeals, with the Central Board of Indirect Taxes and Customs emphasizing data driven compliance and a goal of faceless, paperless and contactless administration.

At the same time, digital compliance has its own challenges. Many small taxpayers face a digital divide, with limited internet access, low digital skills and difficulty in handling complex portals.

There is also concern about system outages, privacy of data and the need for clear communication so that taxpayers understand what is expected of them and how to respond to notices. Thus, while faceless and digital compliance improve transparency and ease for many, they must be paired with strong support systems, helpdesks and simple interfaces.

14.5 TAXATION OF THE DIGITAL ECONOMY

The digital economy has created new ways of doing business that do not fit well into old tax rules based on physical presence and traditional goods and services. Global technology firms can supply digital services like streaming, cloud storage, advertising and app-based platforms in a country without having a clear physical base there. This creates a risk that they may earn large revenues from Indian users but pay little tax in India under older rules.

India has responded with several measures. It introduced an equalization levy on specified digital services such as online advertisements supplied by non-residents to Indian businesses, later expanded to cover e commerce operators on the gross value of supplies to Indian customers. It has also refined rules on significant economic presence to treat certain digital and virtual connections with India as a taxable presence even without physical offices.

These unilateral steps are part of a broader global debate led by organizations such as the OECD and G20 on how to allocate taxing rights in a digital world. India has been an active participant, arguing for changes that give more rights to market jurisdictions where users and consumers are located. At the same time, the rapid growth of the domestic digital economy means that the tax system must keep updating definitions, compliance mechanisms and safeguards against double taxation or non-taxation.

Digitalization also adds complexity in areas like crypto assets, online gaming and cross border digital work. Policymakers are still refining frameworks for withholding tax, reporting obligations and place of taxation in these new spaces. The key challenge is to design rules that are fair and administratively workable without discouraging innovation and investment.

1. The Constitutional Authority to Tax

Before taxing Google, Netflix, or an online gaming app, the government must have the legal power to do so.

• **No Tax Without Law:** As per **Article 265**, the government cannot simply ask for money from digital companies. There must be a specific law passed by Parliament authorizing that tax.

• **Residuary Power (The Safety Net):** The Constitution divides tax powers between the Centre and States. However, when the Constitution was written, the "Digital Economy" did not exist. Therefore, under **Entry 97 of the Union List**, the Central Government (Parliament) has **Residuary Powers**. This allows them to tax any new matter (like digital services) that is not listed in the State or Concurrent lists.

2. Indirect Taxation: GST on Digital Services

With the introduction of the **Goods and Services Tax (GST)** via the 101st Amendment, the taxation of services (including digital ones) became streamlined.

• **Supply of Services:** Digital activities (downloading software, streaming movies) are treated as a "supply of services." Under **Article 246A**, both Parliament and State Legislatures can make laws on GST.

• **Inter-State Trade (IGST):** Most digital transactions are considered **Inter-State trade** (happening between states or involving imports). Under **Article 269A**, the Centre collects **Integrated GST (IGST)** on these supplies. This ensures that even if a service provider is in one state (or country) and the consumer is in another, the tax is collected and shared.

3. Direct Taxation: Income Tax and Online Earnings

The **Income Tax Act, 1961** is the primary tool for direct taxation. The sources highlight specific modern updates relevant to the digital economy, particularly regarding online gaming.

• **Online Games (Section 115BBJ):** The sources highlight that money won from **Online Games** is now specifically taxed. A flat tax rate of **30%** applies to the net winnings from online games.

• **TDS on Online Games (Section 194BA):** To ensure people don't evade this tax, the government uses **TDS (Tax Deducted at Source)**. The gaming app/company must deduct tax before transferring the winnings to the user’s account. There is no threshold limit for this; tax is deducted on the net winnings.

4. The Challenge of "Connecting Factors"

One of the biggest issues in the digital economy is determining *where* a company should be taxed. The sources explain this through **International Treaties** and **Connecting Factors**.

• **Residence vs. Source:** Traditionally, tax is based on **Residence** (where the company is based) or **Source** (where the income is generated).

• **The Digital Problem:** A digital company can have "Source" income in India (millions of users) without having a physical "Residence" (no office) in India.

• **Solution (Treaties):** To solve this, countries enter into **Double Taxation Avoidance Agreements (DTAA)**. The sources note that India negotiates treaties to ensure it gets its fair share of tax from income accruing in India, even if the entity is non-resident.

Check your progress

Q1. What are two major impacts of GST reform on businesses in India

Q2. In simple terms, what is faceless assessment and what problem is it trying to solve

14.6 ENVIRONMENTAL TAXATION AND GREEN INITIATIVES

Environmental taxation uses taxes and cesses to discourage polluting activities and encourage cleaner choices. In India, green taxes are still developing but have gained more attention as tools to address climate change and local pollution.

One example is the coal related cess that was first introduced as a Clean Energy Cess and later renamed the Clean Environment Cess. It was levied on coal mining and imports, with revenues meant to support renewable energy and environmental projects. Although this specific cess has since gone through changes, it showed how tax policy can be linked to climate goals.

States and local bodies have also experimented with green levies such as higher taxes on older polluting vehicles, environment compensation charges on certain vehicle categories in highly polluted cities, and differential road taxes to encourage cleaner fuel vehicles. Some policy proposals argue for a broader carbon tax that would price carbon emissions more directly, but this raises concerns about impacts on growth, inflation and poorer households unless combined with suitable compensation or targeted use of revenues.

Analyses of India’s green taxation efforts suggest that while there are several measures in place, the regime is still fragmented, with lack of uniformity across states, limited coverage and weak enforcement in some areas. There is also a tension between using taxes to reduce fossil

fuel use and the fact that fuel taxes are a major source of revenue for both Union and States. Future reforms may need to create a more coherent framework that balances environmental effectiveness with revenue needs and social protection.

Environmental Taxation and Green Initiatives

Category	Initiative / Law	Explanation
Constitutional Rules	**Article 51A (Fundamental Duties)**	The Constitution says it is the duty of every citizen in India to protect and improve the natural environment and to have compassion (kindness) for living creatures.
	Article 48A (Directive Principles)	The Constitution directs the State (Government) to try to protect and improve the environment and safeguard the forests and wildlife of the country.
Tax/Levies	**Swachh Bharat Cess**	This is a specific tax (cess) mentioned in tax references, used to fund the "Clean India" mission.
Corporate Initiatives	**Environmental Accounting**	This is a method used by businesses to calculate the cost of using natural resources. It involves tracking the use of water, energy, and materials to understand the environmental cost of doing business.
	Environmental Audit	The Ministry of Environment and Forests issued a notification in 1992 making it mandatory for industrial units to submit an "Environmental Statement." This helps industries look at their operations to reduce waste and save material costs.
	Directors' Report (Companies Act 2013)	The law requires companies to include details in their Directors' Report about energy consumption and energy conservation policies.
Key Environmental Laws	**The Environment (Protection) Act, 1986**	This is the main law that covers the protection of the environment. It sets the rules for environmental audits and regulation.

	Pollution Control Acts	Specific laws like the **Water (Prevention and Control of Pollution) Act, 1974** and the **Air (Prevention and Control of Pollution) Act, 1981** are in place to stop water and air pollution.
	National Green Tribunal Act, 2010	An act established to handle legal cases specifically related to environmental protection and conservation.
	Resource Conservation Acts	Laws like the **Forest Conservation Act, 1980** and the **Biological Diversity Act, 2002** focus on saving forests and biodiversity.
Objectives of These Initiatives	**National Level**	The goal is to estimate how much money is spent to protect the environment and to plan how to use resources wisely by reducing waste.
	Corporate Level	For companies, the goal is to show they are following the rules for disposing of hazardous waste and taking measures to control pollution.

14.7 INFORMAL SECTOR AND TAXATION CHALLENGES

India has a very large informal sector that includes small unregistered businesses, casual workers and self-employed persons who often do not appear in official tax records. This sector provides livelihoods for many but also leads to a narrow tax base because a small share of the population pays direct taxes and a limited group of firms is fully compliant with indirect tax rules.

One challenge is identifying and registering informal businesses and workers without placing heavy compliance burdens on them. Many small enterprises operate with low margins and limited capacity to handle complex paperwork or digital systems. Too strict enforcement can push them out of business, while too soft an approach can leave large parts of the economy untaxed and distort competition with formal firms.

GST has tried to bring more small suppliers into the net through thresholds, composition schemes with lower rates and simpler returns, and incentives like input tax credit chains that reward formalization. Direct tax reforms have introduced simpler presumptive taxation for small

businesses and professionals and have expanded the use of information from banks and other sources to detect income that is not reported.

Still, structural factors like cash-based transactions, limited financial literacy and social norms continue to make enforcement difficult. Also, many informal workers have incomes below the tax threshold, so the issue is more about social security and protection than about direct tax collection from them. Future policy must therefore mix tax measures with broader steps such as digital payments promotion, formal labour contracts, targeted support and education to gradually shift activity into the formal net.

Informal Sector and Taxation Challenges

Challenge	Explanation	Government Solution / Rule
1. Keeping Proper Records	Small business owners and professionals in the informal sector often find it difficult or expensive to maintain detailed account books and hire accountants.	**Presumptive Taxation (Sec 44AD, 44ADA):** The government allows small taxpayers to simply declare a percentage of their turnover (e.g., 8% or 6%) as profit. They do not need to maintain detailed books of accounts or get them audited if they follow this scheme.
2. Tax Evasion	Tax evasion (hiding income) creates a "black money" problem. It corrodes the foundation of the tax system because people earn money but do not pay tax on it.	**High Tax on Undisclosed Income:** If the government finds "unexplained money" or "undisclosed investments" (like hidden cash or jewelry), it charges a very high tax rate of **60%** plus a surcharge, effectively making the tax rate **78%** (Section 115BBE).
3. Tracking Income	It is hard for the government to know who is earning income in the informal sector if transactions are not reported.	**TDS (Tax Deducted at Source):** This is described as the "tail of the elephant." By deducting tax when a payment is made (e.g., to a contractor), the government gets a record of the transaction, making it hard for the receiver to hide that income later.
4. High Cash	The informal sector relies	**Disallowing Cash Expenses:** If a business

Transactions	heavily on cash, which leaves no digital trail for the tax department to track.	makes a cash payment of more than **₹10,000** in a single day to a person, that expense is not allowed to be deducted from their profits (Section 40A(3)). This forces businesses to use banking channels.
5. Promoting Digital Economy	Moving informal businesses from cash to digital payments is a challenge.	**Incentives for Digital Payments:** Under Presumptive Taxation (Sec 44AD), if a business accepts payments digitally (not cash), the government assumes a lower profit rate of **6%** instead of **8%**, reducing their tax liability.
6. Audit Burden	Small taxpayers cannot afford the high cost and compliance burden of a Tax Audit by a Chartered Accountant.	**Audit Exemption:** Business owners under the presumptive scheme (turnover up to ₹2 Crore, or ₹3 Crore if receipts are 95% digital) are exempted from getting their accounts audited (Section 44AB).
7. Collecting Tax from Sales	It is difficult to collect tax after a sale is complete in unorganized markets (e.g., scrap dealers, timber).	**TCS (Tax Collected at Source):** The government mandates that sellers collect tax at the time of sale for specific goods like scrap, timber, tendu leaves, and minerals. This ensures tax is captured at the source.

14.8 FUTURE DIRECTIONS OF INDIA'S TAX SYSTEM

Looking ahead, several trends seem likely to shape the future of Indian taxation. First, technology will play a deeper role through real time data, AI and machine learning in risk assessment and automated decision support. This can make tax administration more efficient and targeted, but it will also require strong safeguards for data security, algorithmic fairness and the ability of taxpayers to understand and challenge automated decisions.

Second, there is continuing discussion on simplifying tax structures. Ideas include reducing the number of GST rate slabs, phasing out distortionary exemptions, and making direct tax rates

and slabs more stable and predictable. A simpler system can reduce disputes, improve compliance and make India more attractive for investment, provided that it remains progressive and fair to different income groups.

Third, global coordination will become more important, especially in the digital economy and in areas like minimum corporate tax and information exchange. India will need to align its domestic rules with international agreements while protecting its own revenue interests.

Fourth, environmental considerations are likely to become more central to tax policy, with gradual moves towards more explicit carbon pricing and broader green taxation, combined with relief for vulnerable groups.

Finally, the long-term success of any tax reform will depend on trust. This includes trust that rules are applied fairly, that procedures are simple and respectful, and that tax money is used for visible public goods. Efforts such as faceless assessment, taxpayer charters and better communication are steps in this direction, but they must be backed by consistent practice on the ground.

Check your progress

Q3. Why is the digital economy difficult to tax under old rules based on physical presence

Q4. Give two examples of green or environmental taxes or cesses used or discussed in India.

Q5. Why is the informal sector a challenge for tax policy, and how can formalisation help

14.9 LET US SUM UP

In this unit we have seen that Indian taxation is changing quickly to keep pace with economic, technological and environmental shifts. GST has replaced many earlier indirect taxes and is still being refined to improve credit flows, reduce cascading and offer a more unified market, while also dealing with compliance and rate design issues. At the same time, the move towards faceless assessment and digital compliance in both direct and indirect taxes aims to reduce personal interaction, increase transparency and make processes more convenient and fairer, though it raises new questions about digital access, system reliability and taxpayer support.

We also examined how India is trying to tax the digital economy through measures such as equalization levy and significant economic presence rules and is engaging in global debates on sharing taxing rights. Environmental taxation is emerging as an important tool, with coal related cesses, vehicle based green taxes and discussion on carbon pricing linking revenue policy with climate goals. At the same time, the large informal sector continues to pose challenges for tax base expansion and equity, so reforms must balance enforcement with ease of doing business and social protection. Looking to the future, greater use of technology, simpler and more stable structures, stronger global coordination and greener tax design, combined with efforts to build trust and voluntary compliance, are likely to define the direction of India's tax system.

14.10 FURTHER READINGS

- Government of India (CBDT and CBIC) notes on faceless assessment and e compliance schemes.
- Invest India. "How India's Tax Reforms Are Shaping the Investment Landscape."
- RSIS International. "Taxation in India's Digital Economy: Challenges, Reforms and Opportunities."
- CBGA India. "Carbon Taxes Could Be India's Inclusive Climate Mitigation Strategy."
- Taxmann and other professional portals on green taxation and GST developments.
- RSIS International. "Taxation in India's Digital Economy: Challenges, Reforms, and Opportunities" 2025.
- Invest India. "How India's Tax Reforms Are Shaping the Investment Landscape" 2025.
- TaxGuru. "Faceless Assessment: A Digital Transformation in Tax Administration" 2025.
- Press Information Bureau. "Faceless e Assessment for Income Tax Payers Launched" 2019.
- Bajaj Finserv. "Faceless Assessment in Income Tax: What Is It and Procedure" 2025.
- CBGA India. "Carbon Taxes Could Be India's Inclusive Climate Mitigation Strategy" 2023.

14.11 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q1: Two major impacts are the creation of a common national market with uniform rules across states and the availability of input tax credit that reduces cascading, along with increased digital compliance requirements for businesses.

Ans to Q2: Faceless assessment is an online system where tax assessments are done without physical meetings between taxpayers and officers. It tries to reduce subjectivity, corruption and regional bias and to make the process more transparent and efficient.

Ans to Q3: The digital economy is difficult to tax because firms can earn income from users in a country without having offices or physical presence there, while older rules link taxing rights mainly to physical presence.

Ans to Q4: Examples include the coal related Clean Energy or Clean Environment Cess and higher taxes or charges on polluting vehicles or road usage, often called green tax or environment compensation charges.

Ans to Q5: The informal sector is a challenge because many businesses and workers operate outside formal records, so the tax base remains narrow and compliance is hard to enforce. Formalisation through GST registration, digital payments and simple small taxpayer schemes can gradually widen the base and improve fairness.

14.12 MODEL QUESTIONS

1. Discuss the main achievements and limitations of GST reform as a contemporary change in Indian taxation.
2. Explain the concept of faceless assessment in direct taxes and evaluate its impact on transparency and taxpayer convenience.
3. What are the key tax challenges posed by the digital economy, and how has India tried to address them so far
4. Analyse the role of environmental or green taxes in India. What reforms are needed to make them more effective
5. Why is the informal sector central to debates on India’s tax base and what policy mix can help bring more informal activity into the formal tax net without harming livelihoods