LECTURE NOTES

Direct and Indirect Tax Laws

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What is Tax ?

A tax is a mandatory fee or financial charge levied by any government on an individual or an organization to collect revenue for public works providing the best facilities and infrastructure. The collected fund is then used to fund different public expenditure programs.

If one fails to pay the taxes or refuses to contribute towards it will invite serious implications under the pre-defined law.

Types of Taxes

Be it an individual or any business/organization, all have to pay the respective taxes in various forms. These taxes are further subcategorized into direct and indirect taxes depending on the manner in which they are paid to the taxation authorities.

Let us delve deeper into both types of tax in detail:

Direct Tax

- The definition of direct tax is hidden in its name which implies that this tax is paid directly to the government by the taxpayer
- The general examples of this type of tax in India are Income Tax and Wealth Tax.
- From the government's perspective, estimating tax earnings from direct taxes is relatively easy as it bears a direct correlation to the income or wealth of the registered taxpayers.

Indirect Tax

- Indirect taxes are slightly different from direct taxes and the collection method is also a bit different. These taxes are consumption-based that are applied to goods or services when they are bought and sold.
- The indirect tax payment is received by the government from the seller of goods/services.
- The seller, in turn, passes the tax on to the end-user i.e. buyer of the good/service.
- Thus the name indirect tax as the end-user of the good/service does not pay the tax directly to the government.
- Some general examples of indirect tax include sales tax, Goods and Services Tax (GST), Value Added Tax (VAT), etc.

What is Income Tax?

The most common type of tax that eligible citizens have to pay to the government. A part of your income is paid to the government every year and the government uses this money to fund support the growth and development activities across the country.

- **Income Tax Assessee:**

Any individual who is liable to file taxes and fall in the payable income tax slab is an income tax assessee.

An individual who is having a regular income is exempted from paying tax if his/her included annual income is below the threshold level determined by the government from time to time or income from exempted sources such as agriculture.

- **Income Tax Slabs**

As mentioned earlier, not all individuals shall pay the same amount of tax; the general rule is – the higher your income, the higher amount of tax you will have to pay.

In order to ensure that tax rates and rules are fair rather than uniform, the government uses income tax slabs to determine the rate at which each individual tax assessee is liable to pay income tax.

- **Income Tax Deductions**

Citizens having taxable income in excess of Rs. 2.5 lakhs are liable to pay income tax as per their applicable slab. However, there are a few tax savings options such as ELSS, Mutual Funds, PPF, EPF, tax saver fixed deposits, and others that can be used to reduce the income tax payable by the individual. A majority of these tax saving schemes are available under sections 80C and 80D of the Income Tax Act, 1961.

- **Tax Deducted at Source**

TDS, short for Tax Deducted at Source is considered one of the most common ways of deducting tax by the government from any salaried individual. Other cases of TDS can be seen in the case of interest provided on fixed deposits. However, in this case, also, the tax assessee can get a refund after filing the Income Tax Return (ITR).

- **Tax Evasion Laws and Implications**

Various acts related to taxation have been framed by the Government of India and every citizen is liable to comply with these rules, failing which strict actions may be taken against them. Some of the sections of the taxation laws and penalties imposed for non-compliance are:

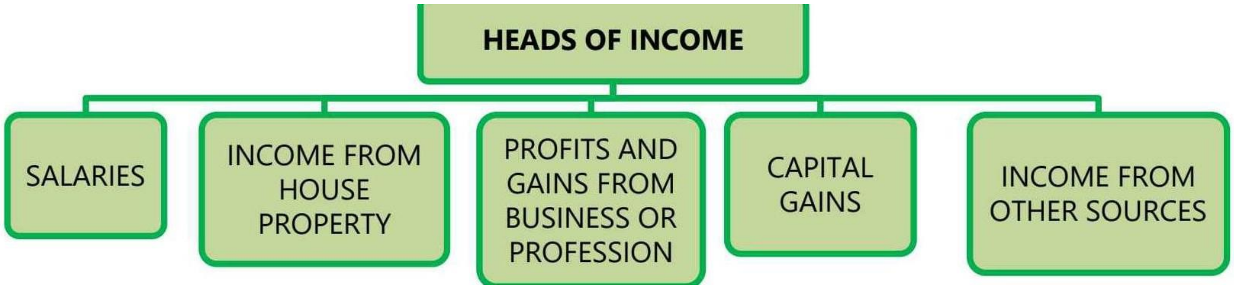
  - Section 140A (1): If an assessee fails to pay the taxes, be it partially or wholly on principle amount of interest, he will be considered as a defaulter. The assessing officer can levy a fine equal to the arrear as per section 221 (1)

- Section 271 (C): In case an assessee doesn’t reveal the actual income or earning, a fine of 100% to 300% can be imposed on the defaulter in this section.

- Section 142 (1) and 143 (2): Under these sections, an income tax notice is sent to the defaulter and if he/she does not respond to it, the assessing officer can ask the assessee to file the return or furnish all details of assets and liabilities in writing.

Paying taxes is an integral part of all the citizens’ life and it helps in the upliftment of every section of the country by providing proper services and provisions. There are many other types of taxes such as GST, value-added tax (VAT), property tax, service tax, sales tax, entertainment tax and so on, that also constitute government funding.

Heads of income and Computation



Section 14 of the Income Tax Act – Heads of Income

As per Section 14 of the Income Tax Act of 1961, an individual can earn income from several means. The computation of income tax is important and must be calculated according to a person's income. For a hassle-free income tax computation, the Act classifies the income into different categories of heads.

The provisions and rules are mentioned in the Income Tax Act. At the end of each financial year, the taxpayer must classify their earnings under these heads of income for accurate tax calculation. Thus, it is essential to know which falls under what category or head. The 5 heads of income stated in this section as explained in detail in the below article.

It is not necessary that every earning individual will have income from all these 5 heads of income. However, classifying one's income on the basis of these heads of income would make ITR filing easier to calculate how much income tax will accrue on them.

Heads of Income Tax

The 5 heads of income are:

- **Income from salary**
- **Income from house property**
- **Income from profits and gain of business or profession**
- **Income from capital gains**
- **Income from other sources**

These above-mentioned heads of income inform when the tax is to be charged and the requirement to be fulfilled for taxation liabilities. Each of these heads of income has its separate conditions that are needed to be fulfilled to make the income generated from these sources taxable. These conditions are mentioned in different Sections of the Income Tax Act.

Income from Salary

The first head of income is income from salary. If there exists a relationship between payer and payee in a firm or agreement, and the relationship is between employer and employee where the employee is being paid a certain amount of remuneration for their services, then the income can be charged under this head of income. A salary could be any sort of monetary compensation. This could be any basic and normal wage, annuity, pension, gratuity, leave encashment, etc.

After making a total aggregate of the total amount of income excluding the exemptions if, at all present, the total amount of gross salary is then charged under this head of income.

All basic salaries along with commissions and bonuses are completely liable to taxation.

Under this head of income, some allowances are exempt from tax under some conditions. Allowances are: As per the Act, a fixed amount of money paid to an employee concerning the labor and service are made by him. The allowance is generally included with the salary unless specific exemptions are mentioned. Every employer must deduct TDS from the salaries of their employees.

An important point to note while calculating taxable salary, the salary is taxable on the 'due basis' or 'receipt basis,' whichever is earlier. For example, if a person receives a salary for March 2022 in April 2022, this salary is taxable in the previous year 2021-2022 as this salary was due in March 2022. Likewise, if the employers give an advance salary of April and May 2022 in March 2022, this salary too is taxable in March 2022.

- Leave travel allowance: Leave allowance trade, or LTA denotes the expenditure incurred for travel when you go on a trip for vacation purposes alone or with a group of friends or family. As this is paid, it is free of tax twice in 4 years.
- Medical allowance: Up to a limit of rupees 15,000 per annum, medical allowance is tax-free, and you can bear the bill and your family.

- Conveyance allowance: You can get a monthly tax exemption of up to Rs.800.

These are some of the many types of allowances and their clauses for tax deductions. Other monetary payments made to employees by an employer also have their methods of taxation.

Income from House Property

Another head of the Income Tax Act is income from house property. This part sheds light and detail about the taxation policy on the house or real estate that you, as a taxpayer, are residing in. Vacant house property is considered as 'self-occupied' in regards to the purpose of income tax. In the situation that a taxpayer owns more than a single self-occupied house, then only one house is treated and considered as a single self-occupancy house property. Rest is considered to be let out.

The second head of the Income Tax Act is dedicated to sections 22 to 27, which correspond to the computation and calculation of the total standard amount of income by a person in the house or property that they rightfully own. The tax amount charged is not acquired from the amount of rent that is received but rather from the property or land as a whole. Nonetheless, if the; and or property is being used for a normal course of business, then the income generated from the rent will also be included to be charged for tax income. All commercially owned residents or properties owned are also subjected to taxes.

For income from house property to be taxable, a few conditions must be satisfied and fulfilled.

- The house property has to consist of a house, building, or any land appurtenant.
- The taxpayer should be the owner of the house property.
- The house property must not be used for any business or professional venture done and carried out by the taxpayer. It can only be used for residential purposes.

Having these conditions met, the income generated by house property thereby becomes chargeable and liable to tax deduction as per the Income Tax Act.

Income from House Property is charged to tax on a notional basis. Tax under this head of income does include income from letting out house property, commercial properties, and any other types of properties. Several deductions like standard deduction, the deduction for interest on home loans (if any), and deduction for municipal taxes paid are also allowed under this head of income.

TDS on rent also needs to be deducted if the value of rent is more than a specified limit.

Income from Profits and Gain of Business or Profession

This is the third head of income under the Income Tax Act. A business includes any kind of trade, commerce, manufacturing, or any nature of trade. Profession implies the acquisition of specific or special knowledge in a particular field after a period of education and verified examination. Under this head of income, profits and gains made during the tenure of business are subjected to complete and total taxation. Profits incurred on the sale of imports, incentives, any interest or form of salary or bonus, and a commission from a firm are all taxable under this head of income in the Income Tax Act. For an income to be charged under the head of income from profits and gains from business or profession, there are some rules and conditions that must be fulfilled according to Section 28 of the Income Tax Act.

- For income to be charged, a business or profession must exist in the first place.
- The business or profession must be carried out by the taxpayer or assessed by themself.
- The profession or business whose income is to be charged must be operational and be carried on for a greater part of the previous year.
- The tax charge is based on the profits and gains made by the business during its running and operating time of the previous year.
- The charge made can be extended to any and all business or profession that is ongoing or being carried on by the assessee.

Only if these conditions are applicable, then the income from profits and gains generated can be taxed under the Income Tax Act. It is important to note that to be charged under this head of income, the business or profession need not be operational throughout the entire previous year. As long as it has been carried on by the assessee for some time during the previous year, it is chargeable.

There are a few types of income that are chargeable under this head of income are:

- Profits generated from the sale of a certain license
- Gains earned by the business during an assessment year
- The profits that an organization makes on its income
- Cash received on the export of a government scheme
- The benefits that a business receives
- Gains, bonuses, or salary that an individual receives due to a partnership with a firm

Income from Capital Gains

Being the fourth head of income under the Income Tax Act, income gained from any capital asset, be it movable or immovable, is deemed taxable. Capital gains are divided into two parts: long-term capital gains and short-term capital gains. These gains are taxed under the head of income – income from capital gains.

When a person sells his capital assets after holding them for 36 months or more, they will fall under long-term capital gain. The applicable tax rate is 20% in the case of LTCG. Alternatively, if he sells capital assets within 36 months, it will be termed as short-term capital gain, and the rate of tax will be 15%. In the case of securities, this is applicable if one sells his holdings within 12 months from the purchase date.

Capital gain is exempt from tax under sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G, or 54GA.

Income from Other Sources

The fifth and last head of income under the Income Tax Act is income from other sources. Any income derived from sources other than the previously mentioned four heads is considered to be under this category of income. Some examples of income from other sources include interest gained from bank deposits, winning in the lottery, or even any sum of money which is more than Rs. 50,000 received from another individual who does not form a part of the taxpayer relative, spouse or if the money is acquired via inheritance or will. All these sources, even if it is gambling or even card games, are chargeable for tax under Section 56(2) of the Act.

Section 145 of the Income Tax Act states the details for the computation and income tax calculator generated from other sources. As per the Section, income from other sources shall be computed and calculated by the regular accounting method which is followed by whoever the assessee is. This can be either in cash or in a mercantile accounting system.

Which Types of Income Come Under Income from Other Source?

Section 56(2) of the Income Tax Act enlists certain incomes which are taxable under this head of income, that is, Income from Other Sources. Some of these incomes include:

- Dividend income
- Interest income
- Family pension income
- Gifts received
- Royalty income

115JC of the Income Tax Act

The Government had introduced profit-linked deductions and incentives to encourage investment and growth in various industries. Many taxpayers misused this provision and became zero tax by paying marginal tax, although they were capable of paying normal tax. Thus, MAT (Minimum Alternate Tax) was introduced for the companies, and AMT (Alternative Minimum Tax) was introduced for taxpayers other than companies under section 115JC of the Income Tax Act. The rate of Alternative Minimum Tax is 18.5% of the Adjusted Total income. Surcharge and CESS are applicable in addition to 18.5%.

The provisions of Alternative Minimum Tax apply to the following category of taxpayers:

- Individual, HUF, AOP (Association of Persons), or BOI (Body of Individuals) if the adjusted total income exceeds INR 20 lacs
- Any other taxpayer (other than the company), irrespective of the total income.

The AMT provisions apply to the above category of taxpayers only if:

- The taxpayer claims a deduction under Section 80H to Section 80RRB (except Section 80P)
- Claims a deduction under Section 35AD.
- Claims a deduction under Section 10AA.

A taxpayer should obtain a report from a chartered accountant if the provisions of AMT apply to him. As per a report under Section 115JC of the Income Tax Act, the CA certifies that the Adjusted Total Income and AMT are calculated as per the provisions of the Income Tax Act.

Conclusion

These are the 5 heads of income under the Income Tax Act of 196. These detail and specify the different incomes and monetary functions that are liable for taxation by the Government. Knowing the details of these 5 heads of income will allow proper management of tax. The taxpayer can be clear as to the nature of the tax they are paying to the Government, and the collection of said tax becomes much smoother and overall convenient. All citizens who are eligible for taxpayers must abide by these heads of income. If any taxpayer is caught not abiding by the clauses mentioned in the Income Tax Act and makes an effort to withhold from paying the due tax amounts, they are punishable by the law's full extent.

Introduction to Goods and Service Tax (GST)

Introduction:

GST is the biggest reform for indirect taxes in India in the post-independence period. It simplified indirect taxation, reduced tax complexities, removed the cascading effect and led to one nation and one tax regime in India. Experts believe that GST will have a huge positive impact on business and change the way the economy functions. In this chapter we shall have a brief introduction on new GST regime introduced in India since July, 2017. Before we are introduced to the system of GST in India let us know the concepts of Direct and Indirect taxes.

Concept of Direct and Indirect Taxes:

A tax may be defined as a fee charged by a government on a product, income or an activity. It is a pecuniary burden laid upon individuals or property owners to support the Government, a payment exacted by legislative authority. A tax "is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority".

Taxes are broadly classified into direct and indirect taxes.

Direct Taxes: If a tax is levied directly on or wealth an individual or an organization it is called direct tax. A direct tax is a kind of charge, which is imposed directly on the taxpayer and paid directly to the Government by the persons (juristic or natural) on whom it is imposed. An incidence of direct tax cannot be shifted by the taxpayer to someone else. The burden of such tax is borne by the payer of tax himself. An important direct tax imposed in India is *income tax*.

Indirect Taxes: If tax is levied on the price of a good or service, then it is indirect tax. The person paying the indirect tax passes on the incidence of tax to some other person. He collects the tax from his customer on sale of goods and services and remits it to the government. The ultimate burden of such tax falls on the final consumer of such goods and services. *If the taxpayer (such as a manufacturer or provider of service or seller of goods) is just a conduit and at every stage the tax incidence is passed on till it finally reaches the consumer, who really bears the brunt of it, such tax is indirect tax.* An indirect tax is one that can be shifted by the taxpayer to someone else.

Indirect taxes are also called consumption taxes, they are regressive in nature because they are not based on the principle of ability to pay. All the consumers, including the economically challenged bear the brunt of the indirect taxes equally.
Indirect taxes are levied on consumption, expenditure, privilege, or right but not on income or property. Hitherto, a number of indirect taxes were levied in India, namely, excise duty, customs duty, service tax, central sales tax (CST), value added tax (VAT), entry tax, purchase tax, entertainment tax, tax on lottery, betting and gambling, luxury tax, tax on advertisements, etc.

Tax on commodities and services: It is levied on commodities at the time of manufacture or purchase or sale or import/export thereof. Hence, it is also known as commodity taxation. It is also levied on provision of services.

Shifting of burden: In the indirect taxes the tax burden is shifted by the tax payer to his customer. The tax is collected through the selling price of goods and services and remitted to the tax department of the government.

Price of goods and services serves as vehicle for indirect taxes. For example, GST paid by the supplier of the goods is recovered from the buyer by including the tax in the cost of the commodity.

No direct pinch to tax payers: Since, value of indirect taxes is generally inbuilt in the price of the commodity or service, most of the time the tax payer pays the tax without actually knowing that he is paying tax to the Government. Thus, tax payer does not perceive a direct pinch while paying indirect taxes. Through the purchase and consumption of various goods and services in our day to day life we are regularly paying several indirect taxes to the government treasury.

Inflationary: As indirect taxation directly affects the prices of commodities and services a rise in indirect taxes leads to inflationary trend.

Wider tax base: Unlike direct taxes, the indirect taxes have a wide tax base. Majority of the products or services are subject to indirect taxes with low thresholds. Hence every person in a nation is indirect tax-payee. Therefore, it is rightly said that *there are two things certain in human life namely, death and taxes.*

Promotes social welfare: High taxes are imposed on the consumption of harmful products (also known as ‘sin goods’) such as alcoholic products, tobacco products etc. This not only curtails their consumption but also enables the State to collect substantial revenue. Thus indirect taxes indirectly promote social welfare.

Regressive in nature: Generally, the indirect taxes are regressive in nature. The rich and the poor have to pay the same rate of indirect taxes on certain commodities of mass consumption. This may lead to further increase the income disparities between the rich and the poor.