International Journal of Enhanced Research in Management & Computer Applications
ISSN: 2319-7471, Volume 7 Issue 2, February-2018, Impact Factor: 3.578

Comparative analysis of Direct and Indirect taxes implications in India

Chetna Yadav

ABSTRACT

In the present paper an attempt has been made to study the taxation structure and direct and indirect taxes implications in India. Direct and indirect taxes are vital to carry adequate revenue to the state for meeting the increasing public expenditure. Both taxes are essential to promote economic growth, fill employment and economic stability. Direct and indirect taxes should side by side and balance each other. However in developing countries, direct taxation has limited scope and hence indirect taxation plays a more significant role. A well oriented system of taxation requires combination of direct & indirect taxes in different proportions. The present study is also to attempts the role of direct and indirect tax in development of Indian economy.

Keywords: Tax Structure, India, direct tax, indirect tax, Ease of doing business etc.

I. INTRODUCTION

Tax is defined as a financial obligation, it is a fee levied by the government of the respective country on income, goods, and activity. The main reason for imposing taxes is that they are the main source of revenue to the government. Taxes are broadly classified as a direct tax and indirect tax, wherein the former is charged directly on the income or wealth of the person, while the latter is imposed on the price of goods and services. A tax is a financial charge or other levy imposed upon a taxpayer (an individual or legal entity) by a state or the functional equivalent of a state to fund various public expenditures. Taxation Structure of any country is the set of rules and laws set up by that particular country for the collection of taxes from the public. The Fundamental objective of collecting Tax is to raise government revenue for development and welfare programs in the country. The Secondary objectives is to maintain economic equalities by imposing tax to the income earners and improving the economic condition of the general people, to encourage the production and distribution of the products of basic needs and discourage the production and harmful ones, to discourage import trade and protect the national industries. Growth and Development of a Country is largely dependent on the Taxation Structure it adopts. High taxation rates and complex tax systems curb growth. Complex Taxation System also results in evasion of taxes and thus increases the parallel economy. Complex Tax Systems are also responsible for hampering the ease of doing business whereas countries with simplified taxation systems has resulted in facilitating ease of doing business as well as growth and development of that particular country. Our starting point is a hypothetical situation where the government wants to lead an expansive economic policy, either through a reduction in direct or indirect taxes, or by increasing transfers or subsidies. We assume that the government wants a specific level on the expansively of the economic policy, here measured by the increase in total consumption of all households.2 We calculate the distribution of the standard of living3 over all persons in the Norwegian population, and how this distribution responds to changes in the tax system. Furthermore, this approach allows us to determine the effects on various characteristics of the distribution of the standard of living. We focus on three aggregated measures of welfare:

a. Average standard of living, measured by the arithmetic mean;
b. the equality of the standard of living, measured by 1 minus the Gini-index; and
c. Sen-welfare, defined as the product of the average standard of living and equality.

We find that all the twelve tax reforms lead to an increase both in the average standard of living and in Sen-welfare. Reduced surtax, income tax, wealth tax and petrol tax lead to reduced equality, while the other tax changes lead to a more equal distribution of the standard of living. In general, an increase in subsidies or tax-deductions directed towards families with children leads to the largest increase in both the mean and the equality of the standard of living, and thereby the largest increase in Sen-welfare. Then follows reduced VAT on food, and the rest of the indirect taxes. The least efficient tax changes in this analysis are reduced taxation on income and wealth. A reduction in taxes or an increase in transfers leads to a partial increase in the standard of living of the households because it allows for increased private consumption. Such tax changes may also lead to reduced public economic activity however, for instance reduced public support to kindergartens.

In the case of a direct tax, the taxpayer is the person who bears the burden of it. Conversely, in the case of an indirect tax, the taxpayer shifts the burden on the consumer of goods and services and that is why the incidence falls on different persons. Direct and indirect taxes include all the different types of taxes levied by the government. Direct taxes include the taxes that cannot be transferred or shifted to another person, for instance the income tax an individual pays directly to the government. In this case, the burden of the tax falls flatly on the individual who earns a taxable income and cannot shift the tax to others. Indirect taxes, on the other hand, are taxes which can be shifted to another person. An example would be the Value Added Tax (VAT) that is included in the bill of goods and services that you procure from others. The initial tax is levied on the manufacturer or service provider, who then shifts this tax burden to the consumers by charging higher prices for the commodity by including taxes in the final price. Both direct and indirect taxes are critical components of governmental revenue and consequently the economy. The variations in the indirect taxes may come down in the future once the Goods and Services Tax bill is passed by the parliament, probably by next year.

Direct taxes

A direct tax is referred to as a tax levied on person's income and wealth and is paid directly to the government, the burden of such tax cannot be shifted. The tax is progressive in nature i.e. it increases with an increase in the income or wealth and vice versa. It levies according to the paying capacity of the person, i.e. the tax is collected more from the rich and less from the poor people. The tax is levied and collected either by the Central government or State government or the local bodies. The plans and policies of the Direct Taxes are being recommended by the Central Board of Direct Taxes (CBDT) which is under the Ministry of Finance, Government of India.

Indirect Tax

Indirect Tax is referred to as a tax charged on a person who consumes the goods and services and is paid indirectly to the government. The burden of tax can be easily shifted to the person. The tax is regressive in nature, i.e. as the amount of tax increases the demand for the goods and services decreases and vice versa. It levies on every person equally whether he is rich or poor. The administration of tax is done either by the Central Government or the State government.

Difference between Direct Tax and Indirect Tax:

There are different implications of direct and indirect taxes on the country. However, both types of taxes are important for the government as taxes include the major part of revenue for the government. Key differences between Direct and Indirect Tax are:

a) Direct tax is levied and paid for by individuals, Hindu undivided Families (HUF), firms, companies etc. whereas indirect tax is ultimately paid for by the end-consumer of goods and services.
b) The burden of tax cannot be shifted in case of direct taxes while burden can be shifted for indirect taxes.
c) Lack of administration in collection of direct taxes can make tax evasion possible, while indirect taxes cannot be evaded as the taxes are charged on goods and services.
d) Direct tax can help in reducing inflation, whereas indirect tax may enhance inflation.
e) Direct taxes have better allocative effects than indirect taxes as direct taxes put lesser burden over the collection of amount than indirect taxes, where collection is scattered across parties and consumers' preferences of goods is distorted from the price variations due to indirect taxes.
f) Direct taxes help in reducing inequalities and are considered to be progressive while indirect taxes enhance inequalities and are considered to be regressive.
g) Indirect taxes involve lesser administrative costs due to convenient and stable collections, while direct taxes have many exemptions and involve higher administrative costs.
h) Indirect taxes are oriented more towards growth as they discourage consumption and help enhance savings. Direct taxes, on the other hand, reduce savings and discourage investments.
i) Indirect taxes have a wider coverage as all members of the society are taxed through the sale of goods and services, while direct taxes are collected only from people in respective tax brackets.
j) Additional indirect taxes levied on harmful commodities such as cigarettes, alcohol etc. dissuades over-consumption, thereby helping the country in a social context.

Similarities between Direct and Indirect Tax

a) Payable to the government.
b) Penalty for the non-payment.
c) Interest on Delayed Payment.
d) Improper administration can lead to tax avoidance or tax evasion.

IMPORTANCE OF DIRECT AND INDIRECT TAXES IN INDIAN ECONOMY

One of the essential characteristics of our tax rising policy is 'the ability to pay'. Indirect taxes are to be borne by the consumers of goods and services irrespective of their financial ability. On the other hand the direct taxes are lesser burden than the indirect taxes to the common people as they are payable on income or profits rather than on goods or services. The indirect tax is also called regressive tax as the demand for products and services decreases proportionately as the amount of taxes increases. Excessive reliance on indirect taxes increases the rich and poor disparity. Direct taxes facilitate in more equitable distribution of income and wealth. Sometimes indirect taxes can facilitate equitable distribution by levying them on luxuries and exempting them on necessaries. Both direct and indirect taxes are alternative methods of achieving any particular redistribution of income and wealth. The other main aspect of taxation is 'proper administration'. The administrative cost of collecting direct taxes is more than that of indirect taxes. Indirect taxes are simple and its cost of collection is stable over a period. From point of view of efficiency and productivity, indirect taxes are better. Indirect taxes are wrapped up in prices and hence they cannot be easily evaded. They are more productive as their cost of collection is the least. However, improper administration of direct taxes leads to tax avoidance and tax evasion which is a loss to the exchequer and widens the gap between rich and poor.

Growth Orientation

Modern government aims at a higher economic growth and attainment of full employment through its fiscal operations. In this regard, indirect taxes have an edge over direct taxes. Indirect taxes can entail a high degree of growth orientation than direct taxes. Direct taxes being progressive in nature cut into the incomes and savings of the people. Direct taxes, thus, discourage saving. Saving is the main source of capital formation in the private sector. When savings and investments are discouraged, economic growth process is obstructed. Thus, in a mixed economy, a highly progressive direct taxation is not conducive to economic growth. Indirect taxes, on the other hand, rest on consumption. Through indirect taxes, consumption can be discouraged and savings can be increased. Progressive indirect taxes on luxuries can reduce conspicuous consumption and restrict the scope of unproductive or socially undesirable investments and release resources which may be channelized into growth-oriented planned programmes.

CONCLUSION

Both the direct and indirect tax has its own merits and demerits. If we talk about the direct taxes they are equitable because they are charged on person, according to their paying ability. The direct tax is economical because its cost of collection is less but however, it doesn't cover every section of the society. On the other hand, if we talk about the indirect tax, they are easy to realize as they are included in the price of the product and services, and along with that, it has an excellent coverage of every section of the society. One of the best advantages of the indirect tax is, the rate of tax is high for harmful products as compared to the other goods which are necessary for life.

REFERENCES

[1]. "Welcome to India in Business : Investment". indiainbusiness.nic.in. Retrieved 2016-11-14. "Directorate of Town Panchayats".
[2]. Article 265 of the Indian Constitution (PDF), archived from the original (PDF) on 9 September 2014, retrieved 2009-04-18
[3]. "Tax Collection in 2015-16", The Times of India, 3 August 2016
[4]. "Inheritance tax on HNIs likely to be reintroduced", The Economic Times, 5 October 2017
[5]. "View: Government should reinstate wealth tax in Budget 2017", The Economic Times, 6 December 2016
[6]. "Direct Taxes Code Bill: Government keen on early enactment". The Times Of India. March 16, 2012.
[7]. "New service tax rate of 14% to come into effect from June 1". Times of India. 19 May 2015. Retrieved 21 May 2015.
[8]. "Swachh Bharat Cess will not be levied on services exempted from tax: CBEC". The Economic Times. The Economic Times. Retrieved 2016-01-14.
[9]. "Krishi Kalyan Cess at 0.5% Levy on all Taxable Services". 2016-04-09.
[10]. "GST will change the way India does business: Who will win, who will lose", The Economic Times, 3 August 2016
[11]. Taxation System in India, India in Business, Ministry of External Affairs, Government of India, Investment and Technology Promotion Division
[12]. "Only jewellers with over Rs12 crore turnover to pay excise duty: finance ministry", Live Mint, 4 March 2016
[13]. "Jewellers' strike: Govt seeks alternatives to excise duty", The Financial Express, 10 March 2016
[14]. "Simplified Central Excise norms for Jewellery Sector notified", Business Standard, 29 June 2016
[15]. R. Sinha, "An International Comparison of Tax Regimes," Centre for Budget and Governance Accountability, 2010.
[16]. M. P. Raiker, "Simplification of Tax Structure," 17 April 2015. [Online]. Available: