Direct and Indirect Taxes

Dr. A. B. Karwa

- Taxes are unilateral payments by citizens to its Government for which there is no *quid pro quo*. In modern day nation-states, taxes are imposed on the basis of a rule of equity and that the rule may be the principle of ability to pay taxes. The best method to determine the principle of ‘ability to pay’ is the income and consumption of a citizen.
- Taxes are levied on income of citizens and on consumption of citizens.

- Taxes levied on the income of citizens are ‘**Direct Taxes’** as the incidence of tax and tax payer is the same person. Income Tax, Wealth Tax, Corporation Tax are some of the examples of direct taxes.
- Taxes on commodities, is essentially a tax on consumption. It is a form of ‘**Indirect Tax’** as the tax payer (producer or trader) and the ultimate bearer of tax (consumer) are two different persons. Excise Duty, Import Duty, Sales Tax etc. are the examples of indirect taxes.

Tax Characteristics

- Taxes are compulsory payments for which there is no quid pro quo.
- The obligation to pay taxes tends to alter the affected individual’s economic behaviour.
- All economic agents (producers of goods and services) have to make certain major decisions, namely, what to produce or what employment to seek, where to produce and how to produce (what factors of production to use and in what proportion to combine them) and taxes affect their decisions.

Kinds of Indirect Taxes

- An **'Origin Based**' tax is one which is levied and/or collected and retained by the jurisdiction of production, a **'Destination Based Tax'**, on the other hand is levied and/or collected and retained by the importing jurisdiction.
- A **'Cascading Tax'** is one which effectively falls on inputs at every stage and thereby increases the cost of production. For example if a cascading sales tax regime is in place where the tax is levied at each and every stage of transaction without factoring the tax paid at earlier stages of transaction.
- Such a tax tends to create distortions through altering the degree of vertical integration.

- A **‘Non-cascading Tax’** on the other hand takes care of and factors in the taxes paid on the inputs at various stages of production. It is more transparent and the consumer or the ultimate user is sure about the tax element included in the sales price.

Financial Relations between the Union and the States

Some Major Central & State Taxes

Centre Taxes	
Direct Taxes	**Direct Taxes:**
▪ Income Tax other than agricultural income ▪ Corporation tax	▪ Taxes on agricultural income.
Indirect Taxes	**Indirect Taxes:** **Tax on sale of goods AND**
▪ Customs Duties ▪ Excise Duties on tobacco and other goods except alcohol for human consumption and ▪ Service Tax (via constitutional 88th amendment Act, 2003) ▪ Taxes on the capital value of the assets ▪ Estate duty in respect of property other than agricultural land. ▪ Terminal taxes on goods or passengers, carried by railway, sea or air; taxes on railway fares and freights. ▪ Taxes on transactions in stock exchanges and futures markets.	▪ Duties in respect of succession to agricultural land. ▪ Estate duty in respect of agricultural land. ▪ Taxes on lands and buildings, mineral rights, vehicle/tolls. ▪ Duties of excise on alcohol for human consumption ▪ Taxes on the entry of goods into a local area for consumption ▪ Taxes on the consumption or sale of electricity. ▪ Taxes on goods and passengers carried by road or on inland waterways. ▪ Taxes on professions, trades, callings and employments. ▪ Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling. ▪ Rates of stamp duty

Direct Taxes

Merits

- Equity
- Certainity
- Relatively elastic
- Creates public consciousness
- Economical
- Anti inflanationary

Demerits

- Tax Evasion
- Arbitrary Rates
- Inconvenient
- Narrow coverage
- Affects Capital Formation
- Effect on willingness and ability to work
- Sectoral imbalance

Indirect Taxes

Merits

- Convenient
- Difficult to evade
- Wide coverage
- Elastic
- Universality
- Influence on pattern of production
- May not affect motivation to work and save
- Social welfare
- Flexibility

Demerits

- High cost of collection
- Increase income inequalities
- Affects consumption
- Lack of social consciousness
- Uncertainty
- Inflationary
- Possibility of tax evasion