

## **New Dimension to India's Taxation Policy: Issues and Challenges in the 21<sup>st</sup> century**

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### **Abstract**

*Tax system, the world over has undergone significant changes during the last twenty years, as many countries across the ideological spectrum and with varying level of development have undertaken reforms. Income tax is a very important direct tax. It is an important and most significant source of revenue of the government. The government needs money to maintain law and order in the country; safeguard the security of the country from foreign powers and promote the welfare of the people. Since our government is wedded to socialistic pattern of society it is the foremost duty of the government to bring out such welfare and development programmes which will bridge the gap between the rich and the poor. All this requires mobilization of funds from various sources. These sources may be direct or indirect. Income tax, being a direct tax, is an important tool to achieve balanced socio-economic growth by providing concessions and incentives in income tax for various developmental purposes. This paper undertakes the analysis of the Indian tax system. It details the evolution of the tax system and its reform over the years and analyses its efficiency and equity implications. The study proposes to analyze new dimensions to India's taxation policy in the changing scenario of taxation in India.*

**Keywords:** Tax System and Policy, Development

### **Introduction**

World over, tax systems have undergone significant changes during the last 20 years as many countries across different ideological spectrum and varying levels of development have undertaken reforms. The wave of tax reforms across the world that began in the mid 1980s actually accelerated in the 1990s motivated by a number of factors. In many developing countries, pressing fiscal imbalance was the driving force. Tax policy was employed as a principal instrument to correct severe budgetary pressures (Ahmad and Stern, 1991). In others, the transition from plan to market necessitated wide ranging tax reforms. Besides efficiency considerations, these tax reforms had to address the issue of replacing public enterprise profits with taxes as a principal source of revenue and aligning tax policy to change the development strategy. Another motivation was provided by the internationalization of economic activities arising from increasing globalization. While the hand, this has entailed significant reduction in tariffs and replacement had to be found for this important and relatively easily administered revenue source, on the other, globalization emphasized the need to minimize both efficiency and compliance costs of the tax system. The supply side tax reforms of the Thatcher-Reagan era also had their impact on the tax reforms in developing countries. The evolution of the Indian tax system was driven by similar concerns and yet, in some ways, it is different and even unique. Unlike most developing countries, which were guided in their tax reforms by multilateral agencies such as the International Monetary Fund, Indian tax reforms have largely borne a domestic brand. They have been calibrated to changes in the development strategy over time while staying in step with the institutional arrangements in the country. Thus, even when the

government sought assistance from multilateral financial institutions, the recommendations of these institutions did not directly translate into an agenda for tax reform. Despite this, the tax system reforms were broadly in conformity with international trends and advice proffered by expert groups and was in tune with international best practices. Such income tax shall be paid on the total income of the previous year in the relevant assessment year. It is an important source of income of Central Government. Thus, it has very significant role among the various sources of revenue of Indian Government. Every Individual and Hindu Undivided Family, whose total income exceeds the exempted limit of income according to Income-tax Act, shall be liable to pay income-tax. Besides this, a Firm, a Company, a co-operative Society and Association of Persons, etc. is also liable to pay income tax. Taxes in India are of two types, Direct and Indirect Tax:-

- Direct Tax, like income tax, wealth tax, etc. is those whose burden falls directly on the taxpayer.
- The burden of indirect taxes, like service tax, VAT, etc. can be passed on to a third party. Income tax is all income other than agriculture income levied and collected by the central government and shared with the states.

### **Pre independence**

In India, this tax was introduced for the first time in 1860, by Sir James Wilson in order to meet the losses sustained by the Government on account of the Military Mutiny of 1857. Thereafter, several amendments were made in it from time to time. At last, in 1886, a separate Income Tax Act was passed. This Act remained in force up to 1917, with various amendments from time to time. In 1918, a new Income Tax Act was passed and again it was replaced by another new Act which was passed in 1922. This Act remained in force up to the assessment year 1961-62 with numerous amendments. The Income Tax Act of 1922 had become very complicated on account of innumerable amendments. The Government of India, therefore, referred it to the Law Commission in 1956 with a view to simplify and prevent the evasion of tax. The Law Commission its report in September 1958, but in the meantime the Government of India had appointed the Direct Taxes Administration Enquiry Committee to suggest measures to minimize inconveniences to assess and to prevent evasion of tax. This Committee submitted its report in 1959. In consultation with the Ministry of Law finally the Income Tax Act, 1961 was passed. Inevitably tax policy in the country has responded to changing development strategy over the years. In the initial years tax policy was guided by a large number of demands placed on the government. These demands can be summarized as the need to increase the level of savings and investment in the economy and hence the need to stimulate growth and ensure a fair distribution of incomes. That in turn meant an effort to raise taxes from those with an ability to pay, with little regard for the efficiency implications of the chosen instruments for the purpose.

The role of history and institutions was also important in shaping India's tax system. Indeed, the nature of the federal polity, the assignment of tax powers, and tax sharing arrangements have influenced the incentives for revenue mobilization and the structure and administration of the taxes in both central and state governments. The overlapping tax systems have made it difficult to enact and implement comprehensive and coordinated tax reforms. Another legacy of the era of planning is selectivity and discretion both in designing the structure and in implementing the tax system. These contributed to erosion of the tax base, created powerful special interest groups, and

introduced the concept of “negotiated settlement” into the tax system. In a closed economy, inefficiencies did not matter and relative price distortions and disincentives to work, save, and invest did not warrant much consideration.

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). Since 1962 several amendments of far-reaching nature have been made in the Income Tax Act by the Union Budget every year, which also contains Finance Bill. After it is passed by both the Houses of Parliament, and receives the assent of the President of India, it becomes the Finance Act. Besides this, amendments have also been made by various Amendment Acts, for instance, Taxation Laws Amendment Act, 1984, Direct Taxes Amendment Act, 1987, Direct Taxes Law (Amendment) Acts of 1988 and 1989, Direct Tax Law (Second Amendment) Acts, 1989 and at last the Taxation Law (Amendment) Act, 1991. The amendments in the Finance Acts, 1992 and 1993, are most based on the recommendations of Chelliah Committee Report. As a matter of fact, the Income Tax Act, 1961, which came into force on 1st April 1962, has been amended and re-amended drastically. It has, therefore, become very complicated both for the administering authorities and the tax payers.

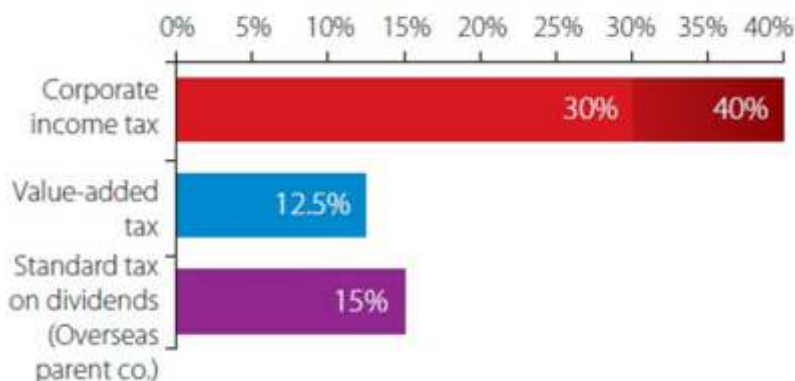
#### **After Independence**

The basic framework for the tax system in independent India was provided in the constitutional assignment of tax powers. The important feature of the tax assignment is the adoption of the principle of separation in tax powers between the central and state governments. The central government has the power to levy the major broad-based and mobile tax bases, which include taxes on nonagricultural incomes and wealth, corporate income taxes, customs duties, and excise duties on manufactured products. Over the years, the last item has evolved into a manufacturers' VAT on goods. The major tax powers assigned to the states include taxes on agricultural incomes and wealth, sales taxes, excises on alcoholic products, taxes on motor vehicles and on transport of passengers and goods, stamp duties and registration fees on transfers of property, and taxes and duties on electricity. States also have powers to levy taxes on entertainment and on income earned by engaging in a profession, trade or employment; some states have retained these powers for themselves, while others have assigned them to local bodies. Although the state list also includes property taxes and taxes on the entry of goods into a local area for consumption, use, or sale, these have been assigned to local bodies. Until 2003 India's constitution did not explicitly recognize and assign to any level of government the power to tax services, However, since all residuary tax powers were assigned to the central government, in 1994, this authority became the basis for levying a tax on selected services.

In 2003 an amendment to the constitution specifically assigned the power to tax services to the central government. Tax policy in India has evolved as an important component of fiscal policy that played a central role in the planned development strategy. In particular, tax policy was the principal instrument for transferring private savings to public consumption and investment. Tax policy was also used to encourage savings and investment, reduce inequalities of income and wealth, foster balanced regional development, encourage small-scale industries on the assumption that they are employment intensive, and influence the volume and direction of economic activities in the country. The evolution of tax policy within the framework of an industrialization strategy based on the public sector, heavy industry, and import substitution has had several implications. First, tax policy was directed to raise resources for the large and

increasing requirements of public consumption and investment irrespective of the efficiency implications it entailed. Second, the objective of achieving a socialistic pattern of society, combined with the large oligopolistic rents generated by the system of licences, quotas, and restrictions, necessitated steeply progressive tax structure in both direct and indirect taxes. Third, the pursuit of a multiplicity of objectives enormously complicated the tax system with adverse consequences on efficiency and horizontal equity. It also opened up large avenues for evasion and avoidance of taxes. The disregard for efficiency considerations was a part of the import substituting industrialization strategy. Fourth, not only did all of this require differentiation in tax rates based on arbitrary criteria, but plan priorities also legitimized selectivity and discretion in tax policy and administration. Once selectivity and discretion were accepted as legitimate, it mattered little whether these were exercised as intended. This provided enough scope for the special interest groups to influence tax policy and administration. Fifth, the influence of special interest groups, changing priorities, and the lack of an information system and scientific analysis led to ad hoc and often inconsistent calibration of policies. Finally, the poor information system was the cause of selective application of the tax system as well as its effect. This section summarizes the evolution of the major central taxes and provides an overview of the state taxes. For the central government, the major direct taxes are personal income and corporate taxes; the major indirect taxes are excise duties, customs duties, and service tax. At the state level, the major initiative in recent times has been the introduction of the VAT, and the discussion limits itself to this measure.

### Corporate Taxes in India



The government of India imposes a progressive income tax on taxable income of individuals. Hindu Undivided Families (HUF), Companies (Firms), Co-operative societies and trusts. The income tax department is governed by the Central Board for Direct Taxes (CBDT) and is part of Department of Revenue under the Ministry of Finance. The individual income tax is a pro-tax with three brackets. No income tax is applicable on income up to INR 110,000 per year (INR 145,000 for women and INR 195,000 for senior citizens). The highest bracket is 30%, with a 10% surcharge (tax on tax) for income above Rs. 10 lakh (10 million). All Income taxes are subject to 3% education, applicable on the tax paid. Deductions and rebates are providing housing

purchases, rent, long term savings, and insurance.

Business income is taxed at a flat rate of 33% for Indian companies and 40% for foreign companies. Dividends are income free to shareholders. Instead, companies are charged a 15% dividend distribution tax. Long term capital gains stands at 20% (gold, real estate, etc.) With indexation benefits provided for inflation adjustments. For sales of shares in recognized stock exchanges, long term capital gains (held above 1 year) are not taxed, and short term gains are charged 10% tax (less than 1 of holding) provided the Securities Transaction Tax (STT) has been paid. All other short term gains are clubbed with income year the gains occur.

**Liberalization - A New Era:** Since 1991 tax system in India has under gone a radical change, in line with liberal economic policy and WTO commitments of the country. Because of the size of the country, its multilevel fiscal framework, the unique reform experience, and difficulties in calibrating reforms posed by institutional constraints, the Indian tax reform experience can provide useful lessons for many countries. The reform, by itself, is an important enough reason for a detailed analysis of the tax system in India. Unfortunately, unlike in many developed countries where major tax reform initiatives were followed by detailed analysis of their impact, no serious studies analyzing the economic impact of tax reforms have been conducted in India.

· Reduction in customs and excise duties. Excise duty on most commodities ranges between 0 to 16%. Only on seven items imposed at 32%, viz, motor cars, tires, aerated soft drinks, air conditioners, polyesters filament yarn, pan masala and chew tobacco. Duty is charged at 30% on petrol with additional excise duty at Rs. 7 per litre. The said rates are subject to exempt and deductions thereon as may be notified from time to time. Central VAT (CENVAT) is applicable to practically all manufacturing goods, so as to avoid cascading effect on duty. Peak customs duty reduced from 220% (in 1991) to 30% (in 2002). The general project import duty (for new projects and substantial expansion of existing projects) reduced from 85% to 25%. Import duty under EPCG Scheme is 5%. R & D imports of the customs duty. Export made with imported inputs get concessions in form of duty drawback, duty entitlement pass book scheme and advance license. Many type of industries such as 100% EOU and units in free trade zone get facility of zero import duty. An authority is made for advance ruling for foreign investor.

- Lowering corporate tax: For domestic this is levied @ 35% plus surcharge of 5% where as for a foreign company (including branch/project offices) it is @ 40% plus surcharge of 5% An Indian registered company, which is a subsidiary of foreign company, is also considered an Indian company for this purpose.
  - Widening of the tax base and toning up the tax administration: Conventionally, the criteria of a good tax system have been classified in terms of equity, efficiency and simplicity.
- a) Equity. Whilst everyone agrees that a taxation system should be equitable or fair there has been much debate over which constitutes equity in the distribution of the taxation burden. The most commonly accepted principle of taxation equity is the to-pay principle. This principle states that the distribution of the burden of taxation should be commensurate with taxpayers to pay tax. Those who are more able to pay tax should pay more tax. Ability to pay is normally measured by a taxpayer's income (possibly augmented by a measure of their wealth).
  - b) Efficiency. Another important criterion of a good tax system is efficiency. The taxation regime should promote an efficiency allocation of the

economy's scarce resources. In the absence of externalities and other types of market failure, this is normally unachieved by the tax system having the minimum possible distortion affect on individual the choices and allowing the invisible hand of market forces to achieve Pareto optimality. The choices referred to her include the choices between work leisure, consumption and savings the patterns of consumption, and so on.

- © Simplicity. Compliance costs and administration costs are the two aspects of a tax's simplicity. Obviously, these two type cost should be minimized. International studies have found that both administrative costs and compliance costs are higher for personal income tax than for broad-based consumption taxes.

**Basis of Charge of Income Tax:-** The following basic principles emerge from the charging section:

- Income Tax is an annual tax on income.
- Income of previous year is taxable in the next following assessment year at the rate or rates applicable to that assessment year. However, there are certain exceptions to this rule.
- Tax rates are fixed by the annual Finance Act.
- Tax is charged on every person as defined in Section 2 (31).
- The tax is charged on the total income of every person computed in accordance with the provisions of the Act.
- Income tax is to be deducted at the sources or paid in advance as provided under provisions of the Act.

The total income is computed on the basis of the residential status of the assesses in the manner provided hereunder and is classified into the following five heads:

- Income from Salaries
- Income from House Property
- Profits of Business or Profession
- Capital Gains and
- Income from other sources.

For computing the total income of an assesses and the tax payable by him the following step by step procedure is followed:

- Classify the income under each of the above five heads and then deduct from the income under each head the deductions permissible under the Act in respect of that head of income. The balance of amount left under each head of income is its assessable income.
- Total up the assessable income of each head and the aggregate of all these assessable incomes is called the Gross Total Income.
- From the Gross Total Income, thus arrived at, deduct the deductions permissible under sections 80C to 80U of the Act for computing total income. The balance left after subtracting the allowable deductions is called the Total Income.

### **Changing Paradigms of Tax Policy and Reform**

In the literature on tax design and reform, the thinking on what constitutes the best tax system and an implementation strategy to achieve it have undergone considerable change over the years, mainly because of the changing role of the state in development and internationalization of economic activities. Designing tax policy and reforming an

existing tax regime can be two distinctly different exercises, not always generating the same set of results. It is possible to argue that the objective of tax reform should be to chart the course for turning a given tax regime into one that has been “optimally” designed. The history of the existing system, however, as well as political and administrative constraints, could place limits on such a transition path. For instance, a comprehensive consumption tax of the value-added tax (VAT) variety might be best implemented at the national level, to avoid issues relating to treatment of interstate taxation. But the assignment of tax powers in India could make that transition difficult if not impossible. Reform therefore might have to explore other alternatives such as a dual VAT system.

One important school of thought, which focuses on the design of a tax system, is known as the optimal taxation school. It recognizes the difficulties of achieving the first-best solution and emphasizes the need to minimize the deadweight losses in exploring the second-best solutions. Here one can distinguish two key approaches. The first approach, based on the assumption that government is all-powerful, fully informed, benevolent, and driven by efficiency considerations, derives the following result: to minimize the excess burden of raising a given amount of revenue, consumption should be taxed and the optimal rate of tax on individual commodities should be related to the direct and cross-price elasticity's of demand. In the special case when the compensated cross-price elasticity's are zero, the optimal tax rate is inversely proportional to the direct, compensated price elasticity of demand (Ramsey rule). The lower the compensated price elasticity of demand, the smaller the movement away from the undistorted first-best optimum in response to the tax so that it pays to tax the lower-elasticity goods at higher rates. Since tax structures designed on these principles would involve taxing necessities, the need to address distributional concerns becomes paramount. Incorporating distributional considerations into this paradigm introduces discussions of optimal income tax, applications of which interestingly do not support sharply progressive tax structures. The second approach recognizes that the government typically lacks the information on elasticity's and is subject to lobbying when it is willing to tax different goods at different rates. This approach leans more heavily toward taxing consumption at uniform rates across goods. According to this approach, while efficiency (and distribution weights) is clearly desirable in the design of tax policy, administrative capacity, attention to local institutions and political realities are equally, if not more, important. The principal concern is not to design a system that will be optimal, but to adopt a system that will minimize tax-induced distortions and at the same time, be administratively feasible and politically acceptable. The basic Harberger reform package for developing countries that are price takers in the international market consists, among other things, of uniform tariffs and a broad-based VAT. Panagariya and Rodrik examine the rationale for uniformity in the context of import tariffs and argue that while the case for uniform tariffs is not watertight, uniformity minimizes the pressures for favorable (higher) rates on some goods over others. The commitment to a uniform tax rate introduces a free-rider problem for industries to lobby for lower rates for themselves (since such lower rates are then extended to everyone).

While the literature has focused more on the first approach described above, optimal taxation has played only a limited role in the formulation of actual tax policy. The second approach, combined with administrative cost considerations, is a closer approximation of the approach of tax policy practitioners. The thrust of most tax policy

advice within this approach is to enhance the ability of the tax system to raise revenue while minimizing relative price distortions. This involves efforts to broaden the tax base, lower the rates, and reduce rate differentiation of both direct and indirect taxes. Adoption of uniform tax rates has been an important feature of practical approaches to tax reform. A broader base requires lower rates to be levied to generate a given amount of revenues. It also helps to ensure horizontal equity, and it is desirable from the political economy viewpoint because elimination of exemptions and concessions reduces administrative costs as well as the influence of special interest groups on tax policy. Lower marginal rates not only reduce disincentives to work, save, and invest, but also help to improve tax compliance. The preference for broad-based and uniform rates of taxation is thus guided by the need to eliminate an arbitrary array of tax differentials determined more by special interest group politics than pursuit of economic efficiency. Further, the limited infrastructure and capacity of tax administrations in developing countries constrain them from effectively administering complicated tax regimes. Broad-based systems of taxation applying uniform rates are a mechanism for providing stability and simplicity to the tax system.

The introduction of a VAT is an important component of recent tax reform packages in many countries, especially in the context of declining emphasis on import tariffs. Keen and Ligthart show that in small open economies, any revenue-neutral tariff cut accompanied by a price-neutral, and destination based VAT will enhance both net revenue and welfare. While this result is contested, especially in the context of developing economies with significant informal sectors, that debate does not extend to cases where a VAT seeks to replace a cascading type of sales tax or broad-based excise duty. In large economies, however, complete replacement of revenue from international trade taxes by a VAT may not be possible since it might be associated with unacceptably high tax rates; even if it were acceptable, the revenue might not accrue to the central government in a federal setup like India where the states have traditionally held the power to levy sales taxes. There may thus be a need to explore all other alternatives. In many countries, the reason for levying a VAT has as much, if not more, to do with replacing the cascading-type sales taxes, which are often, confined to the manufacturing stage, than to substitute for import duties as a source of revenue. In many cases the expansion of the tax base accompanying the VAT, caused both by extending the tax to the stages following manufacturing and by the self-enforcing nature of the tax, has led to higher revenue productivity. Often, this expansion of the VAT tax base has strengthened the information base for tax administration, resulting in improved compliance for other taxes and thereby enhancing the overall productivity of the tax system. Thus, although a VAT is not necessarily a “money machine,” the conventional conclusion holds that a properly administered VAT is the best way to make up for the revenue loss from trade liberalization.

Some recent theoretical explorations have argued that because the VAT is a tax on the formal sector of the economy and is often combined with weak administration, it helps the informal economy to spread, which is not conducive for development. This argument, however, applies to many other taxes levied in developing countries. In fact, most taxes in developing countries are levied on the formal sector. In the context of tariffs, it has been shown that smuggling—the informal sector counterpart in the case of imports—lowers both revenue and welfare. Moreover, the economic agent has to contend with high transaction costs simply because he is in the informal sector. The extent to which a VAT encourages the informal sector also varies from country to



country. This argument against the VAT also overlooks the dynamism created by the formal sector as it opens up avenues to expand businesses.

Another critique of the appropriateness of the VAT in developing countries is based on market structures. Das-Gupta argues that under imperfect competition, since neither the gains from an input tax credit nor the entire tax burden need to be passed on to the consumer, a turnover tax may produce both more revenue and greater welfare than a VAT. This result, however, is based on a static framework. In a dynamic context, the taxpayers in a turnover-based tax system can integrate vertically, thereby avoiding taxes and potentially undermining production efficiency. Further, such a tax regime would perpetuate tax spillovers both across jurisdictions within the country and across international borders. These would undermine the competitiveness of the domestic industry and violate common market principles. Thus, as stated by Bird, "One may criticize VAT in both theory and practice, and much more such analysis and criticism is not only to be expected but also welcomed. In the end, VAT almost certainly works better both in theory and practice in most countries than any feasible alternative." Again, as Bird states, "the most basic lesson . . . from experience to date with implementing VAT in developing and transitional economies . . . is . . . that doing it right is in most respects a matter more of art than of science. . . the behaviour of the informal sector depends. . . largely on the interaction between formal institutions such as the tax administration and the prevalent norms and customs in a country. . . ." Apart from concerns of efficiency, tax policy has often been guided by the need to pursue the objective of redistribution. Most policy analysts in the 1950s and 1960s assigned redistribution a central focus in tax policies and considered that an ideal tax system should have a highly progressive personal income tax combined with a high corporate income tax. In fact, in the 1950s and 1960s, the marginal rates of personal income taxes were set at confiscatory levels in many countries. Redistribution was not merely an obsession in countries with interventionist strategies such as India but was fashionable even in countries such as the United States and Britain. In these countries, marginal income tax rates were set above 90 percent immediately after the Second World War. That high marginal tax rate persisted in the United States until 1963. Three important factors led to moderation in the pursuit of redistribution through tax policy. First, experience showed that highly progressive tax systems did little to reduce inequality in developing countries as they were neither progressive nor comprehensive. Empirical studies in the United States and Chile showed that the income redistribution and reduction in inequality achieved by the tax systems were insignificant. Second, a redistributive tax system can impose additional costs on the economy, including administrative costs, compliance costs, economic efficiency costs, and political costs. Third, the focus of equity in fiscal policy itself has shifted from "reducing the incomes of the rich" to "increasing the incomes of the poor" and in this, the alternative approach of using expenditure programs for poverty alleviation has attracted greater attention. In theory the design of a tax system for developed countries today would rely largely on consumption taxes (VAT) on all goods and services applied at a more or less uniform rate. However, in the presence of large informal sector and constraints in implementing effective expenditure-based redistribution measures, it may be necessary to have a combination of income and consumption taxes, the latter covering all goods and services, at fairly uniform rates. But such an option may not be easily available, with a tax system already in place. The task therefore is to reform the existing tax system so as to minimize the excess burden of taxation within the broad contours of the existing

system. This involves reforms of all major taxes at the central, state, and local levels. The direction of reform as guided by the literature on tax reforms in developing countries includes:

- scaling down of and possible elimination of trade taxes over time;
- reform of existing domestic indirect taxes to transform them into comprehensive consumption taxes on goods and services: this should cover both national and sub national taxes;
- a moderately progressive personal income tax;  
a corporate income tax at a rate equivalent to the highest marginal rate of the personal income tax.

Probably the most important aspect of the advice for developing countries in designing their tax systems is to keep the administrative dimension at the center rather than the periphery of reform efforts. Poor administrative capacity creates a wedge between the structure of the tax on paper and what actually works in practice. Apart from eroding revenue productivity, poor administration results in the perpetuation and even the spread of the informal economy, significant deadweight losses, and the violation of horizontal equity. Tax policy, or for that matter any policy, stands on the tripod of architecture, engineering, and management. Architecture provides the design of the tax system to be achieved, which is guided by the objectives of tax policy. Engineering provides the mechanics to achieve it, and these are provided by the nature of institutions and systems involved in tax collection. Management provides the implementation strategy and action, which, among others things, depends on the political support and vision and the nature of administrative agencies and the information system. The three legs of the tripod are interdependent. A tax policy is only as good as it is administered; so it is important to design the tax system keeping the administrative capacity in mind. Similarly, the nature of tax institutions and systems will have to be adapted to conform to the design of the tax system and the implementation capacity. Further, administrative capacity should be continuously augmented to keep pace with changing requirements of tax policy. In other words, reform of the tax system involves both its structure and operations, is a continuous process, and has to be calibrated constantly. A complementary action in this regard is the building of proper information system.

#### **Residence Rules**

The total income of an individual is determined on the basis of his residential status in India, is as follows:-

- i. For 60 days during the year and 365 days during the preceding four years. Individuals fulfilling neither of these conditions are non-residents. (The rules are slightly more liberal for Indian citizens residing abroad or leaving India for employment abroad.)
- ii. A resident who was not present in India for 730 days during the preceding seven years or who was non-resident in nine out of ten preceding years, is treated as not ordinarily resident. In effect, a newcomer to India remains not ordinarily resident. For tax purposes, an individual may be resident, non-resident or not ordinarily resident.

**Non-Resident and Non-Resident Indians:** Residents are on worldwide income. Non residents are taxed only on income that is received in India or arises or is deemed to arise in India. A person not ordinarily resident is taxed like a non-resident but is also liable to tax on income accruing abroad if it is from a business controlled in or a profession set up in India. Capital gains on transfer of assets acquired in foreign

exchange are not taxable in certain cases. Non resident Indians are not required to file a tax return if their income consists of only interest and dividends, provided taxes due on such income are deducted at source. It is possible for non-resident Indians to avail of these special provisions even after becoming residents by following certain procedures laid down by the Income Tax Act.

**Table – 1. Taxability of individuals**

Status	Indian Income	Foreign Income
Resident and ordinarily resident	Taxable	Taxable
Resident but not ordinary resident	Taxable	Not Taxable
Non Resident	Taxable	Not Taxable

**Table-2. TDS Chart**

S. No.	Section of Act	Nature of Payment in Brief	Rate for Non Company (%)	Rate for Company (%)	Date within which TDS has to be remitted	Qtrly. Return Form No.
1.	192	Salaries	Average rate	-	Within 1 week from last day of the month in which the deduction is made	24Q
2.	193	Interest on securities > Rs. 10,000 (up to 31/05/07, Rs. 2,500)	10	20	-do-	26Q
3.	194A	Interest other than interest on securities > Rs. 10,000	10	20	-do-	26Q
4.	194B	Lottery / Cross Word Puzzle > Rs. 5,000	30	30	-do-	26Q
5.	194BB	Winnings from Horse Race > Rs. 2000	30	30	-do-	26Q
6.	194C(1)	Contracts > Rs. 20,000	2	2	-do-	26Q
7.	194C(2)	Sub-contracts Advertisements > Rs. 20,000	1	1	-do-	26Q
8.	194D	Insurance Commission > Rs. 5000	10	20	-do-	26Q
9.	194EE	Refund of NSS > Rs. 2500	20	-	On the day of deduction itself	26Q
10.	194F	Repurchase of units by MF/UTI	20	-	Within 1 week from last day of the month in which the deduction is made	26Q
11.	194G	Commission on sale of lottery tickets > Rs. 1000	10	10	-do-	26Q
12.	194H	Commission or Brokerage > Rs. 2500	10	10	-do-	26Q
13.	194I	Rent paid for (a) Land (b) Buildings (c) Land appurtenant to a building (including factory building) (d) Plant & Machinery (e) Equipment (f) Furniture & Fittings > Rs. 1,20,000	15 (Individual & HUF) 20 others	20	-do-	26Q
14.	194J	Professional / Technical charges Royalty & Non compete fees > Rs. 20000	10	10	-do-	26Q
15.	194LA	Compensation on acquisition of immovable property > Rs. 1,00,000 w.e.f. 01/10/2004	10	10	-do-	26Q
16.	195/196B/196C /196D/196E	Payment to non-residents	Rates in force	Rates in force	-do-	27Q

**Table-3.** Individuals and HUFs

	Income level	Income tax Rate
i.	Where the total income does not exceed Rs. 1,50,000/-	NIL
ii.	Where the total income exceeds Rs. 1,50,000/- but does not exceed Rs. 5,00,000/-	10% of amount by which the total income exceeds Rs. 1,50,000/-
iii.	Where the total income exceeds Rs. 3,00,000/- But does not exceed Rs. 5,00,000/-	Rs. 15,000/- + 20% of the amount by which the total income exceeds Rs. 3,00,000/-
iv.	Where the total income exceeds Rs. 5,00,000/-	Rs. 55,000/- + 30% of the amount by which the total income exceeds Rs. 5,00,000/-

In case of individual being a woman resident in India and below the age of 65 years at any time during the previous year:-

- Gross amount of income tax payable is then calculated on this total income according to the rates prescribed by the Finance Act for the relevant assessment year and the rates prescribed under different sections of the Act. From the gross tax payable, tax rebate under section 88E is to be deducted. The balance is the net tax liability, subject to any advance tax paid or tax deducted or collected at source.

**The purpose of tax:-** Income tax has its vital role in the direct taxes. In the beginning, the object of imposing income-tax was to compensate financial losses which were occurred in 1957 due to freedom revolution. At present it has following objectives:

- The government has to perform several functions for the welfare of the country and people, e.g., to safeguard the security of the country from foreign enemies, to maintain law and order in the country, to develop public utility work etc. For this purpose the Government needs finance. The Government gets a large portion of revenue through income tax every year. Thus income tax has a leading place in rearranging money to the Government permanently.

**Table -4.** In case of an individual resident who is of the age of 65 years or more at any time during the previous year:-

	Income level	Income tax Rate
i	Where the total income does not exceed Rs. 2,25,000/-	NIL
ii	Where the total income exceeds Rs. 2,25,000/- But does exceed Rs. 3,00,000/-	10% of the amount by which the total income exceeds Rs. 2,25,000/-
iii	Where the total income exceeds Rs. 3,00,000/- But does not exceed Rs. 5,00,000/-	Rs. 7,500/- + 20% of the amount by which the total income exceeds Rs. 3,00,000/-
iv	Where the total income exceeds Rs. 5,00,000/-	Rs. 47,500/- +30% of the amount by which the total income exceeds Rs. 5,00,000/-

Further, the amount of income tax as computed in accordance with above rates, and after being reduced by the amount of tax rebate shall be increased by a surcharge at the rate of 10% of such income tax, provided that the total income exceeds Rs. 10 lacs. Thus, in case of individuals/HUFs no surcharge shall be payable if the total income is below Rs. 10 lacs.

**Table-5.** Association of Persons (AOP) and Body of Individuals (BOI)

	Income level	Income tax Rate
i	Where the total income does not exceed Rs. 1,50,000/-.	NIL
ii	Where the total income exceeds Rs. 1,50,000/- . But does exceed Rs. 3,00,000/-.	10% of the amount by which the total income exceeds Rs. 1,50,000/-.
iii	Where the total income exceeds Rs. 3,00,000/- . But does not exceed Rs. 5,00,000/-.	Rs. 15,000/- . +20% of the amount by which the total income exceeds Rs. 3,00,000/-.
iv	Where the total income exceeds Rs. 5,00,000/-.	Rs. 55,000/- +30% of the amount by which the total income exceeds Rs. 5,00,000/-.

Surcharge: The amount of income tax as computed in accordance with above rates, and after being reduced by the amount of tax rebate shall be increased by a surcharge at the rate of 10% of such income tax. Provided that the total income exceeds Rs. 10 lacs.  
Education Cess: 3% of the total of Income tax and Surcharge.

**Table – 6.** Co-operative Society

	Income level	Income tax Rate
i	Where the total income does not exceed Rs.10,000/-.	10% of the income.
ii	Where the total income exceeds Rs. 20,000/- . But does exceed Rs. 3,00,000/-.	Rs. 1,000/- . +20% of income in excess of Rs. 10,000/-.
iii	Where the total income exceeds Rs.20,000/-.	Rs. 3000/- . +30% of the amount by which the total income exceeds Rs.20,000/-.

Firm:- Income-tax: 30% of total income. Surcharge: The amount of income tax as computed in accordance with above rates, and after being reduced by the amount of tax rebate shall be increased by a surcharge at the rate of 10% of such income tax provided that the total income exceeds Rs. 1 crore. Education: 3% of the total of income tax and surcharge.

Local Authority:- Income-tax 30% of total income. Surcharge. Nil, Education 3% of income-tax

**Table – 7.** Fringe Benefit

Fringe Benefit	Taxable Percentage	Effective Tax Rs.
Medical reimbursements	20%	6.8%
Telephone bills	20%	6.8%
Employee Stock Options (Difference between market value and purchase price on vesting date)	100%	33.99%

Domestic Company:- Income-tax 30% of total income. Surcharge. The amount of income tax as computed in accordance with above rates, and after being reduced by the amount of tax rebate shall be increased by a surcharge at the rate of 10% of such income tax provided that the total income exceeds Rs. 1 crore. Education cess, 3% of the total of income-tax and Surcharge.

Company other than a Domestic Company:- @ 50% of on so much of the total income as consist of (a) royalties received from Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after the 31 day of March, 1961 but before the 1<sup>st</sup> day of April, 1976; or (b) fees for rendering technical services received from Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after the 29<sup>th</sup> day of February,

1964 but before the 1<sup>st</sup> day of April 1976 and where such agreement has in either case, been approved by the Central Government; The amount of income tax as computed in accordance with above rates and after being reduced by the amount of tax rebate shall be increased by a surcharge at the rate of 2.5% of such income tax provided that the total income exceeds Rs. 1 crore.

- **Removing of Disparities:** The Government of India has the aim of establishing “Socialistic Society”. This aim can only be achieved when the disparities and inequalities between rich and poor are removed. The Government is moving towards success in achieving its aim gradually through income tax. Keeping this aim, the Government has introduced slab system of income tax.
- **Encouragement to savings and investments:** The Government has introduced such type of many provisions in Income tax Act which encourages the assesses to make savings and increase investments. For example, a person who gets insured for himself or his children or deposits some amount under certain schemes, his gross total income is reduced by this amount subject to a maximum amount of Rs. 1, 00,000. This provision, on one hand is encouraging the assesses for savings and, on the other hand, is promoting investments. Likewise it, there are other provisions in income tax act which encourage to savings and investments of the assesses.
- **Capital formation:** There are several tax saving schemes which encourage the assesses for making investments. These schemes ultimately lead a way towards huge capital formation in the country.

### **Conclusion**

India has demonstrated tremendous growth in recent years, making it one of the most competitive markets in the world. However, with this growth, we have also seen the emergence of a highly competitive talent market and a rise in the cost of attracting, retaining and motivating key talent, as companies increasingly understand the importance of employing the best people. As companies continue to face volatile business environment made worse with aggressive competition and scarce talent, of giving out hefty salary increases will continue. Companies are constantly looking at meaningful ways of rewarding in workforce. Pay plans will continue to grow in popularity. Increasingly companies will use these plans to improve competitive positioning, enhance productivity, and adjust organization and business priorities to suit the changing business environment.

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