ROLE OF DIRECT AND INDIRECT TAX IN DEVELOPMENT OF INDIAN ECONOMY

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Abstract

Central 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. The study clearly shows that taxes plays an important role in Indian economy development; Tax incentives such as tax holiday for setting up industries in backward regions, which induces business firms to set up industries in such regions, Tax revenue collected by government is also utilized for development of infrastructure in backward regions.

Keywords: Central direct tax, economic stability, employment and development etc.

INTRODUCTION

Tax, in general, is the imposition of financial charges upon an individual or a company by the Government of India or their respective state or similar other functional equivalents in a state. The computation and imposition of the varied taxes prevalent in the country are carried on by the Ministry of Finance's Department of revenue. Taxes come in many avatars – income tax, sales tax, corporate tax, service tax and so on. There are so many types of taxes that an average Indian pays that often you pay a tax without even knowing that you're paying it! The purpose of taxation is to finance government expenditure. One of the most important uses of taxes is to finance public goods and services, such as street lighting and street cleaning. The tax policy of a country has to achieve several objectives. To mobilise resources for the public exchequer is among the most important one. In India, taxation has been used as a powerful instrument of fiscal policy. Taxation alone constitutes more than one-half of total budget resources. 'In 1960-61, 52.2 percent of the total resources came from taxation' in 1970-71, it contributed 56.9 percent of total resources of the government of India the corresponding figure were 55 9 and 51.9 per cent in 1980-81 and 1991-92 respectively. The tax revenue in India shows a tremendous and continuous increase over the time period. Even in post reforms era more than half of the total expenditure of central government was financed from tax revenue. 'In 1994-95, taxation contributed 54.6 per cent of total resources of the government of India. Thus, the taxation has come to stay a major source of financing the activities of the government. Since public goods and services do not allow a nonpayer to be excluded, or allow exclusion by a consumer, there cannot be a market in the good or service, and so they need to be provided by the government or a quasi-government agency, which tend to finance themselves largely through taxes. Taxes in India are levied by the Central Government and the state governments. Some minor taxes are also levied by the local authorities such as the Municipality. Broadly, there are two types of taxes that the Indian government levies on its citizens – direct tax and indirect tax.

DIRECT TAXES

Direct taxes are those which are paid **directly to the government by the taxpayer.** These taxes are not paid deducted and paid on behalf of the taxpayer. It's imposed on the people and organizations directly by the government. This tax liability has to be paid by the taxpayer in question and cannot be transferred to any other entity for payment. Key examples of direct taxes are Income tax, Wealth tax and Corporation tax.

1. Income Tax

Income tax is the most common and most important tax that an Indian must pay. It is charged directly on the income of a person. The rate at which it is charged varies, depending on the level of income. It's charged to individuals, co-operative societies, firms, companies, Hindu Undivided Families (HUFs), trusts and any artificial judicial person. Income tax is charged on an income known as "taxable income", which is:

Taxable income = (total income) – (applicable deductions and exemptions).

The different heads of income under which income tax is chargeable are:

a. Income from house and property.
b. Income from business or profession.
c. Income from salaries.
d. Income in the form of capital gains.
e. Income from other sources.

It is levied differently for different people depending on their residential status.

2. Corporate Tax

Levied on companies who exist as separate entities from their shareholders. Foreign companies are taxed on income that arises, or is deemed to arise, in India. It is charged on royalties, interest, gains from sale of capital assets located in India, fees for technical services and dividends. Includes Minimum Alternative Tax (MAT) which was introduced to bring Zero Tax companies under the income tax net, whose accounts were made in accordance with the Companies Act. Includes Dividend Distribution Tax (DDT) which is a tax levied on any amount declared, distributed or paid as dividend by any domestic company. International companies are exempt from this tax. Includes Securities Transaction Tax (STT) which is a tax levied on taxable securities transactions. There is not surcharge applicable on this.

3. Wealth Tax

Wealth tax is charged on the benefits derived from property ownership. The same property will be taxed every year on its current market value. Wealth tax is charged whether the property in earning an income or not. The tax is levied on the individuals, HUFs, and companies alike. Chargeability depends on residential status. The following will not be taxed as they are "working assets":

a. Assets held as stock in trade.
b. Property held as a commercial complex.
c. Gold deposit bonds.
d. House property held for business or profession.
e. House property let out over 300 days in a year.

Direct taxation in India is overseen by the Central Board of Direct Taxes or the CBDT, which was formed as a result of the Central Board of Revenue Act, 1924. The CBDT is a part of the Department of Revenue in the Ministry of Finance and is responsible for the administration of the direct tax laws. It also provides inputs and suggestions for policy and planning of the direct taxes in India. The CBDT is the hub and nexus of all direct taxation policy and enforcement. It is headed by a CBDT Chairman, and comprises of six members who are also Special Secretary to the Government of India.

INDIRECT TAXES

An indirect tax is a tax collected by an intermediary from the person who bears the ultimate economic burden of the tax. It can be shifted by the taxpayer to someone else. An indirect tax may increase the price of a good so that consumers are actually paying the tax by paying more for the products.

Some important Indirect taxes imposed in India are as under

1. **Customs Duty:** Customs Duty is a tariff or tax imposed on goods when transported across international borders. The purpose of it is to protect the country's economy, jobs by controlling the flow of goods, especially the restrictive and prohibited goods, in and out of the country. Hence, simply put, it is the tax imposed on imports and exports of goods.
2. **Central Excise Duty:** It is the tax which is charged on excisable goods that are manufactured in India and are for domestic consumption. It is mandatory to pay Central Excise duty on the goods manufactured, unless if they are exempted.
3. **Service Tax:** The Service Tax is levied on the gross or aggregate amount charged by the service provider on the receiver.
4. **Sales Tax:** Sales Tax in India is a form of tax that is imposed by the Government on the sale or purchase of a particular commodity within the country. Sales Tax is imposed under both,

Central and State Government Legislation. Generally, each state follows its own Sales Tax Act and levies tax at various rates.

5. **Value Added Tax (VAT):** It is a tax on the estimated market value added to a product or material at each stage of its manufacture or distribution, ultimately which is passed on to the consumer. It is a multi-point levy on each of the entities in the supply chain.
6. **Securities Transaction Tax (STT):** STT is a tax levied on all transactions done on the stock exchanges. STT is applicable on purchase or sale of equity shares, derivatives and equity oriented mutual funds. A person becomes investor after payment of STT at the time of selling securities (shares). Selling the shares after a period of 12 months comes under long term capital gains and one need not have to pay any tax on that gain. In the case of selling the shares before 12 months, one has to pay short term capital gains @10% flat on the gain.

A part from the above mentioned indirect taxes, there are several other indirect taxes in India like entertainment tax, Luxury tax, Octroi and Stamp duty.

Table 1: Composition of Central Direct and Indirect Taxes

Year	Total Direct Tax Revenue (INR billions)	% of Direct Tax to total	Total Indirect Tax Revenue (INR billions)	% of Indirect Tax to total	Total tax collection (INR billions)
1991-92	152.07	22.57	521.54	77.43	673.61
1992-93	181.31	24.29	565.05	75.71	746.36
1993-94	202.98	26.8	554.45	73.2	757.43
1994-95	269.66	29.22	653.28	70.78	922.94
1995-96	335.63	30.18	776.61	69.82	1112.2
1996-97	388.91	30.2	898.71	69.8	1287.6
1997-98	482.74	34.67	909.71	65.33	1392.2
1998-99	465.91	32.4	971.97	67.6	1437.9
1999-00	579.58	33.75	1137.9	66.25	1717.5
2000-01	683.06	36.27	1200.4	63.73	1883.5
2001-02	691.97	37.13	1171.8	62.87	1863.7
2002-03	830.85	38.7	1315.8	61.3	2146.7
2003-04	1050.9	41.58	1476.6	58.42	2527.5
2004-05	1328.5	43.79	1705.5	56.21	3033.9
2005-06	1652.5	45.32	1994	54.68	3646.5
2006-07	2302.5	48.83	2412.6	51.17	4715.1
2007-08	3122.4	52.8	2791	47.2	5913.5
2008-09	3338.5	55.32	2696.5	44.68	6035
2009-10	37775	60.75	2438.8	39.25	6213.7
2010-11	4459.9	56.51	3431.8	43.49	7891.7
2011-12	5006.5	55.77	3970.2	44.23	8976.7
2012-13	5702.57	53.15	5027.34	46.85	10729.99

Source: Various Issues of Statistical handbook on Indian Economy and Reserve Bank of India.

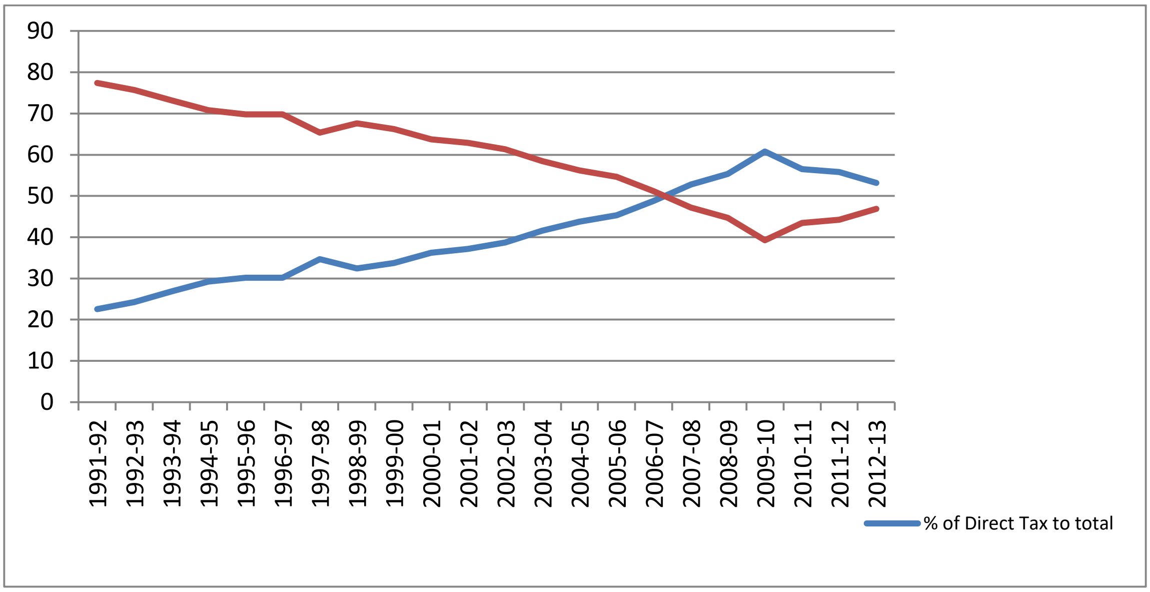

Figure 1: Trend Lines of Direct and Indirect taxes

Table 1 depicts that central direct tax revenue has been increasing from 1991-92 to 2009-10 i.e., 22.57 per cent to 60.75 per cent except 1998-99 when it has decreased to 32.40 per cent from 34.67 per cent. It starts decreasing continue after 2009-10 to 2012-13.On the other hand, central indirect tax revenue has been decreasing year by year from 1991-92 to 2009-10 i.e., 77.43 per cent to 39.25 per cent except 1998-99 when it has increased from 65.33 to 67.60 and then starts continue increasing after 2009-10 to 2012-13 . In other words, the revenue contribution of central indirect tax has remained higher in previous years as compared to central direct tax revenue but now the situation has changed. Now the proportion of central direct tax revenue is higher than central indirect tax to total central tax revenue. The contribution of central direct tax has been calculated 53.15 per cent to total whereas it has been 46.85 per cent in case of central indirect tax revenue.

IMPORTANCE OF CENTRAL 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.

ROLE OF DIRECT AND INDIRECT TAXES IN DEVELOPMENT OF ECONOMY

The role of taxation in developing economies is stated as follows:

1. Resource Mobilisation

Taxation enables the government to mobilise a substantial amount of revenue. The tax revenue is generated by imposing: Direct Taxes such as personal income tax, corporate tax, etc., Indirect Taxes such as customs duty, excise duty, etc.

2. Reduction in Inequalities of Income

Taxation follows the principle of equity. The direct taxes are progressive in nature. Also certain indirect taxes, such as taxes on luxury goods are also progressive in nature. This means the rich class has to bear the higher incidence of taxes, whereas, the lower income group is either exempted from tax (direct taxes) or has to pay lower rate of duty (indirect taxes) on goods consumed by the masses. Thus, taxation helps to reduce inequalities of income and wealth.

3. Social Welfare

Taxation generates social welfare. The social welfare is generated due to certain undesirable products like alcoholic products, tobacco products and such other products are heavily taxed, which restricts their consumption, which in turn facilitates social welfare.

A part of the tax revenue is utilised for social development activities, such as health, education and family welfare, which also improve social welfare as well as social order in the society.

4. Foreign exchange

Taxation encourages exports and restricts imports. Generally, developing countries and even the developed countries do not impose taxes on export items. For instance, in India, exports are exempted from excise duty, VAT, customs duty and other duties.

However, there is customs duty on imported goods. Therefore, taxation helps to: Earn foreign exchange through the promotion of exports.

5. Regional Development

Taxation plays an important role in regional development; Tax incentives such as tax holiday for setting up industries in backward regions, which induces business firms to set up industries in such regions, Tax revenue collected by government is also utilised for development of infrastructure in backward regions.

6. Control of Inflation

Taxation can be used as a tool of controlling inflation. Through taxation, the Government can control inflation as follows:-

1. If inflation is due to high rise in prices of essential items, then the Government may reduce the rate of indirect taxes.
2. If inflation is due to increase in demand, the Government may try to cut down the effective demand by increasing the tax rate. Increase in tax rate may restrict consumption, which may reduce demand, and subsequently inflation may be controlled.

CONCLUSION

Both direct and indirect taxes are important for our country as they are linked with the overall economy. Both are collected by the central and respective state governments according to the type of tax levied and are important for the government as well as growth perspective of the country. However taxing of both direct and indirect is indispensable in modern public finance. In countries like India having people with varied economic backgrounds, the Government should more focus on direct taxes rather than indirect taxes by ensuring proper administration of direct taxes to eradicate tax avoidance and tax evasion. It concluded that the contribution of central direct tax to total central tax revenue has increased year by year whereas central indirect tax contribution has decreased. Taxation system playing important role in the growth of economic and progressive growth are possible due to both type of taxes.

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