Lesson no. 6 – Tax Payments

TAX in India

Taxes are levied by governments on their citizens to generate income for undertaking projects to boost the economy of the country and to raise the standard of living of its citizens. The authority of the government to levy taxes in India is derived from the Constitution of India, which allocates the power to levy taxes to the Central and State governments. All taxes levied within India need to be backed by an accompanying law passed by the Parliament or the State Legislature.

The payment of tax is beneficial on multiple levels including the development of the nation, betterment of infrastructure, the upliftment of the society, and even for welfare activities for the nation.

Types of Taxes

There are two main categories of taxes, which are further sub-divided into other categories. The two major categories are direct tax and indirect tax. There are also minor cess taxes that fall into different sub-categories. Within the Income Tax Act, there are different acts that govern these taxes.

1. Direct Tax

Direct tax is tax that are to be paid directly to the government by the individual or legal entity. Direct taxes are overlooked by the Central Board of Direct Taxes (CBDT). Direct taxes cannot be transferred to any other individual or legal entity.

Sub-categories of Direct Taxes

The following are the sub-categories of direct taxes:

1. **Income tax:** This is the tax that is levied on the annual income or the profits which is directly paid to the government. Everyone who earns any kind of income is liable to pay income tax. For individuals below 60 years of age, the tax exemption limit is Rs.2.5 lakh per annum. For individuals between the age of 60 and 80, the tax exemption limit is Rs.3 lakh. For individuals above the age of 80, the tax exemption limit is Rs.5 lakh. There are different tax slabs for different income amounts.

Apart from individuals, legal entities are also liable to pay taxes. These include all Artificial Judicial Persons, Hindu Undivided Family (HUF), Body of Individuals (BOI), Association of Persons (AOP), companies, local firms, and local authorities.

2. **Capital gains:** Capital gains tax is levied on the sale of a property or money received through an investment. It could be from either short-term or long-term capital gains from an investment. This includes all exchanges made in kind that is weighed against its value.
3. **Securities transaction Tax:** STT is levied on stock market and securities trading. The tax is levied on the price of the share as well as securities traded on the ISE (Indian Stock Exchange).
4. **Prerequisite Tax:** These are taxes that are levied on the different benefits and perks that are provided by a company to its employees. The purpose of the benefits and perks, whether it is official or personal, is to be defined.
5. **Corporate tax:** The income tax paid by a company is defined as the corporate tax. It is based on the different slabs that the revenue falls under. The sub-categories of corporate taxes are as follows:

- **Dividend distribution tax (DDT):** This tax is levied on the dividends that companies pay to the investors. It applies to the net or gross income that an investor receives from the investment.
- **Fringe benefit tax (FBT):** This is tax levied on the fringe benefits that an employee receives from the company. This include expenses related to accommodation, transportation, leave travel allowance, entertainment, retirement fund contribution by the employee, employee welfare, Employee Stock Ownership Plan (ESOP), etc.
- **Minimum Alternative Tax (MAT):** Companies pay the IT Department through MAT which is governed by Section 115JA of the IT Act. Companies that are exempt from MAT are those that are in the power and infrastructure sectors.

2. Indirect tax

Taxes that are levied on services and products are called indirect tax. Indirect taxes are collected by the seller of the service or product. The tax is added to the price of the products and services. It increases the price of the product or service. There is only one indirect tax levied by the government currently. This is called GST or the Goods and Services Tax.

GST: This is a consumption tax that is levied on the supply of services and goods in India. Every step of the production process of any goods or value-added services is subject to the imposition of

GST. It is supposed to be refunded to the parties that are involved in the production process (and not the final consumer).

GST resulted in the elimination of other kinds of taxes and charges such as Value Added Tax (VAT), octroi, customs duty, Central Value Added Tax (CENVAT), as well as customs and excise taxes. The products or services that are not taxed under GST are electricity, alcoholic drinks, and petroleum products. These are taxed as per the previous tax regime by the individual state governments.

3. Other taxes

Other taxes are minor revenue generators and are small cess taxes. The various sub-categories of other taxes are as follows:

- **Property tax:** This is also called Real Estate Tax or Municipal Tax. Residential and commercial property owners are subject to property tax. It is used for the maintenance of some of the fundamental civil services. Property tax is levied by the municipal bodies based in each city.
- **Professional tax:** This employment tax is levied on those who practice a profession or earn a salaried income such as lawyers, chartered accountants, doctors, etc. This tax differs from state to state. Not all states levy professional tax.
- **Entertainment tax:** This is tax that is levied on television series, movies, exhibitions, etc. The tax is levied on the gross collections from the earnings. Entertainment tax also referred as amusement tax.
- **Registration fees, stamp duty, transfer tax:** These are collected in addition to or as a supplement to property tax at the time of purchasing a property.
- **Education cess:** This is levied to fund the educational programs launched and maintained by the government of India.
- **Entry tax:** This is tax that is levied on the products or goods that enter a state, specifically through e-commerce establishments, and is applicable in the states of Delhi, Assam, Gujarat, Madhya Pradesh, etc.
- **Road tax and toll tax:** This tax is used for the maintenance of roads and toll infrastructure.

Benefits of taxes

The purpose of taxes is to provide the government with funds for spending without inflation. Taxes are used by the government for a variety of purposes, some of which are:

- Funding of public infrastructure
- Development and welfare projects
- Defense expenditure
- Scientific research
- Public insurance
- Salaries of state and government employees
- Operation of the government
- Public transportation
- Unemployment benefits
- Pension schemes
- Law enforcement
- Public health
- Public education
- Public utilities such as water, energy, and waste management systems

Tax is levied on a wide range of income stemming from salary, profits from business, property rental, etc. There are also wealth taxes, sales taxes, property taxes, payroll taxes, value-added taxes, service taxes, etc.

Advantages of Paying Taxes

It is compulsory and beneficial for anyone who earns a taxable salary (which is one that exceeds the basic exemption limit) to file their income tax returns. This is the case even if the tax liability is zero after deductions. However, even if your income is less than the basic exemption limit, there are advantages to filing taxes. Here are some of the benefits of paying your taxes on time:

- **Loan approvals**: When applying for a loan, especially home loans, vehicle loans, etc., major banks can request a copy of your income tax returns. This can be ITR from the last 2 to 3 years. Having ITR can even help to get a higher loan amount or to get your loan application reconsidered in case it was rejected at first. This is because banks calculate your ability to repay the loan based on your income. Income tax returns provide a clear picture of the income and the taxes that were paid on it in the previous years.

- **Visa applications:** Many foreign consulates require you to furnish your income tax returns of the previous years during the visa interview. While for some the most recent one will be sufficient, others require up to 2-3 years' worth of returns to be furnished. This is mandatory for the UK, US, Europe, and Canada, but not so much for South East Asian countries and the Middle East. This is because income tax returns are a proof that you are not trying to leave the country to evade taxes. Even when traveling abroad for leisure or business, it is always prudent to carry your ITR receipts as this will come in handy in the case of any emergency when you have to seek the help of a consulate.
- **Self-employed individuals:** Freelancers, consultants, entrepreneurs, and partners of firms are not eligible for the Form 16. If their annual income exceeds the basic exemption limit, then ITR receipts can be furnished as proof of income. It is also proof of taxes paid. This will come in handy during any financial or business transaction.
- **Government tenders:** This depends on the individual government department with no specific strict rules, yet ITR receipts are sometimes requested to be furnished when applying for any government tenders. This is to ensure that you have sufficient income and can support the payment obligations.
- **Carrying forward of losses:** Short-term or long-term capital losses are usually carried forward to be adjusted against the capital gains made in the subsequent years. For example, the long-term capital loss of one year can be carried forward for up to 8 consecutive years that immediately succeed the year in which the loss had occurred. However, a long-term capital loss can be adjusted only against a short-term capital gain of that year. Short-term capital gains, however, can be adjusted against both short-term and long-term gains. However, this can only be availed if income tax returns have been filed.
- **Claiming tax refunds:** Any refunds that are due from the IT Department can only be claimed if income tax returns have been filed. Even if income is below the tax exemption bracket, there could be refunds from different savings instruments that can be claimed if ITRs are filed. An example is fixed deposits, on which there is tax deducted at source at 10%.
- **High-cover life insurance:** Life cover or a term policy with sum insured that ranges from Rs.50 lakh to Rs.1 crore can be availed only by furnishing income tax returns which helps in the verification of annual income. Such a high insurance cover is only given when there is a high income for which income tax return receipts are necessary.
- **Compensation**: For self-employed individuals, ITR receipts may have to be furnished in order to claim compensation in the event of a motor vehicle accident that results in a disability or

accidental death. This is because, in order to arrive at the appropriate compensation, income of the person is to be established first.

Penalty for not Paying Taxes

The government can impose penalties of varying degrees on any individual or legal entity who evades taxes. The penalty is dependent on the category of the tax that has not been paid. This means that the amount that is owed as taxes should be paid and in addition to that, the fine as well as its interest is to be paid as the penalty.