Foundations of Tax Regime

Why should taxes be paid?

- Revenue Augmentation
- Regulation
- Equal distribution of wealth

What is a tax?

- Tax is a compulsory exaction of money by public authority for public purposes enforceable by law and is not payment for services rendered.

How should an ideal tax system be?

- Equity and fairness- vertical and horizontal
- Certainty
- Convenience
- Efficiency
- Elasticity
- Productivity
- Flexibility
- Diversity
- Simplicity

Constitutional Aspects of Tax Regime

Sources of public finance

- Taxes
- Domestic Borrowing
- External Borrowing

Where does the Government get power to tax?

- Article 265 of the Constitution lays down that no tax shall be levied or collected except by the authority of law. Schedule VII divides this subject into three categories:
- Union list (Article 246(1) of the Constitution specifies that Parliament has exclusive powers to make laws with respect of any of the matters enumerated in List I in the Seventh Schedule to Constitution)
- State list (As per Article 246(3) State Government has exclusive powers to make laws with respect to matters enumerated in List II)
- Concurrent list (both Parliament and state Government can pass legislation)

Three tier structure

- The power to levy taxes and duties is distributed among the three tiers of Governments, in accordance with the provisions of the Indian Constitution.
- The main taxes/duties that the Union Government is empowered to levy are Income Tax (except tax on agricultural income, which the State Governments can levy), Corporation tax Customs duties, Central Excise and Sales Tax and Service Tax.

- The principal taxes levied by the State Governments are Sales Tax (tax on intra-State sale of goods), Stamp Duty (duty on transfer of property), State Excise (duty on manufacture of alcohol), Land Revenue (levy on land used for agricultural/non-agricultural purposes), Duty on Entertainment and Tax on Professions & Callings.
- The Local Bodies are empowered to levy tax on properties (buildings, etc.), Octroi (tax on entry of goods for use/consumption within areas of the Local Bodies), Tax on Markets and Tax/User Charges for utilities like water supply, drainage, etc.

- This arrangement has undergone a change with GST
- Most indirect taxes such as Excise duty, service tax, purchase tax, VAT, cesses, surcharges have been subsumed in GST

Modes of Transfer

- Tax sharing
- Grants-in-aid
- Borrowings

Mechanisms of Transfer

- Transfers take place through three channels—
- Finance Commission
- Planning Commission and
- directly from the central government

Two major forms of taxation

- Direct Taxation- Income as base of tax
- Indirect Taxation- consumption as base of tax

income tax act, 1961

- The two legal internationally accepted bases of taxation:
- (i) Residence based tax system and
- (ii) Source based tax system
- Generally, a resident of a country is liable for tax on its world income, while a nonresident is taxed only on income sourced in the country.

In case of companies

- section 6(3) of the ITA, a company is treated as a resident of India for Indian tax purposes and taxed in India in respect of its worldwide income if
- A) it is either incorporated under the laws of India or
- B) its place of effective management is in India
- In the above scheme of taxation, source of income play crucial role since the country of source has a right to tax income and residence countries' relieve double taxation.

Incidence of tax depends upon residential status

- Sec.5 of Income tax Act, 1961 provides scope of total income
- Sec.9 of the Income tax Act, 1961 – source based taxation
- For instance,
- Income from business connection in India
- Income from property in India
- Salary earned in India
- Dividend payable by an Indian company outside India
- Interest/royalty/fees for technical services payable by
  i. The govt
  ii. A resident, unless w.r.t. a debt for business or profession or earning of income by them outside India
  iii. A non-resident, if w.r.t. a debt for business or profession or earning of income by them inside India

DOUBLE TAXATION AVOIDANCE AGREEMENTS

Residence jurisdiction and source jurisdiction

- Residence jurisdiction arises because of the nexus between the country and the person earning the income.
- Source jurisdiction arises on account of the nexus between the country and the activities that generate income.
- This source-based taxation often gives rise to the problem of double taxation, where the same income could be taxed twice - in India, and also in the country of residence of the taxpayer.

What is double taxation?

- Double taxation means taxing the same income twice, once in the home country and again in host country.
- No rules of international law prohibit international double taxation. So it is for the countries in the international arena to solve double taxation problems.

Methods of avoiding double taxation

- Countries throughout the world are following various methods of avoiding double taxation.
- They are as follows.
- (1) Unilateral relief
- (2) Bilateral relief
- (3) Multilateral relief
- (4) Non-tax treaties

What are DTAAs?

- Double Taxation Avoidance Agreements are treaties between two or more States
- Tax treaties do not choose between applicable domestic and foreign law. Instead, they recognize that each contracting state applies its own law, and then **limit the contracting states'** application of that law.
- Thus, treaty rules **do not "allocate"** jurisdiction to tax to the contracting states. States have original jurisdiction to tax, and by concluding tax treaties they agree to restrict their substantive tax law reciprocally.
- In situations in which an overlapping of substantive tax law is expected to occur, states which are parties to tax treaties decide which of them shall be bound to withdraw its tax claim.

Methods of offering relief

- Exemption method
- Credit method

Permanent Establishment (PE)

- Art.7 Business Profits + Art.5 Permanent Establishment= Assigns taxability of the non-resident entity in India
- The words ‘permanent establishment’ postulate the existence of substantial element of an enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country. It should be such as that it would amount to a virtual projection of the foreign enterprise of one country into the soil of another country

- Types of PE
  - Basic rule PE
  - Construction/ Installation PE
  - Service PE
  - Agency PE

Indirect taxes

What is GST?

- It is a valued added tax
- Goods and Services Tax means a tax on supply of goods or services, or both, except taxes on supply of alcoholic liquor for human consumption
- GST is based on Vat concept of allowing input tax credit of tax paid on inputs, input services and capital goods, for payment of output tax. This will avoid cascading effect of taxes.
- Dual Concurrent levy

Goods and Service Tax

- Effective from 1st July 2017
- Goods and Services Tax (GST) will be on 'supply' of goods or services or both, in India
- **Intra-state supply** of goods and services
- Central Goods and Services Tax Act, 2017 (CGST)
- State Goods and Services Act, 2017 (SGST)
- Union Territory Goods and Services Tax Act, 2017 (UTGST)
- **Inter-state supply** of goods and services
- Integrated Goods and Services Tax Act, 2017 (IGST)
- GST Compensation Cess will be payable on pan masala, tobacco products, coal, aerated waters, motor cars etc.

- Central Excise duty will continue on petroleum products i.e. petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas and aviation turbine fuel. These products are out of GST at present and may be brought under GST later.
- Tobacco products will be subject to excise duty plus GST.
- Alcoholic liquor will be subject to State duty. This product is out of GST

Goods and Service Tax Council

- Article 279A in Constitution of India makes provision for constitution of GST Council.
- GST Council is the Apex Constitutional Authority to decide policies of GST.
- The GST Council will make recommendations to Union and States relating to GST.
- GST Council has been constituted *vide* Notification No. SO 2957(E) dated 15-9-2016. Union Finance Minister is Chairman of Council. Following are members of Council - (a) Union Minister of State in-charge of Revenue or Finance and (b) Minister in-charge of Finance or Taxation or any other Minister nominated by each State Government.
- Vice Chairperson of GST Council will be elected by GST Council from amongst its members.
- Decision in GST Council will be taken with at least 75% of weighted average voting in favour of the decision. Union Government will have 33.33% voting power and States will have 66.67% voting power.