Lecture 29

Principles of taxation and tax structure in India

India has a well developed tax structure with a three-tier federal structure, comprising the Union Government, the State Governments and the Urban/Rural Local Bodies. 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), 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.

Since 1991 tax system in India has under gone a radical change, in line with liberal economic policy and WTO commitments of the country. Some of the changes are:

- Reduction in customs and excise duties
- Lowering corporate Tax
- Widening of the tax base and toning up the tax administration

Direct Taxes

Personal Income Tax

Individual income slabs are 0%, 10%, 20%, 30% for annual incomes upto Rs 50,000, 50,000 - 60,000, 60,000 - 1,50,000 and above 1,50,000 respectively.

Corporate Income Tax

For domestic companies, 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 a foreign company, is also considered an Indian company for this purpose.

General Tax Incentives for Industries:

- 100% deduction of profits and gains for ten years is available in respect of the following:

  - Any enterprise carrying on the business of developing, maintaining and operating infrastructure facilities viz., roads, highways, bridges, airports, ports, rail systems, industrial towns, inland waterways, water supply projects, water treatment systems, irrigation projects, sanitation and sewage projects, solid waste management systems.
  - Undertakings engaged in generation or generation and distribution, transmission or distribution of power, which commence these activities before 31.3.2006.
  - Any company engaged in scientific and industrial research and development activities, approved by the prescribed authority, before 31.3.2003.
  - Any undertaking which develops, operates, maintains an Industrial Park or Special Economic Zone before 31.3.2006.
  - Notified Industrial Undertakings set up in the North Eastern region including seven north-eastern states and the state of Sikkim.
  - Undertakings developing and building housing projects approved by the local authority before 31.3.2001and which are completed before 31.3.2003.

- 100% deduction for seven years for undertakings producing or refining mineral oil.
- 100% deduction from income for first five years and 30% (for persons other than companies: 25%) in subsequent five years is available in respect of the following:

  - Company which starts providing telecommunication services whether basic or cellular including radio paging, domestic satellite service, network or trunking, broad band network and internet services before 31.3.2003.
  - Industrial undertakings located in certain specified industrially backward states and districts.
  - Undertakings which begin to operate cold chain facilities for agricultural produce before 31.3.2003.
  - Undertakings engaged in the business of handling, storage, transportation of food grains.

- 50% deduction for a period of five years is available to undertakings engaged in the business of building, owning and operating multiplex theatres or convention centres constructed before 31.3.2005.
- Tax exemption of 100% on export profits for ten years upto F.Y. 2009-10, for new industries located in EHTPs and STPs and 100% Export Oriented Units. For units set up in Special Economic Zones (SEZs), 100% deduction of export income for first five years followed by 50% for next two years, even beyond 2009-10.
- Tax exemption of 100% of Export profits for ten years for new industries located in Integrated Infrastructure Development Centres or Industrial Growth Centres of the North Eastern Region.

- Deduction of 50% of export profits from the gross total income. The deduction would be restricted to 30% for financial year 2003-04 and no deduction is allowable subsequently.
- Deduction from the gross total income of 50% of foreign exchange earnings by hotels and tour operators. The deduction would be restricted to 30% for financial year 2003-04 and no deduction is allowable subsequently.
- 50% deduction of export income due to export of computer software or film software, television software, music software, from the gross total income. The deduction would be restricted to 30% for financial year 2003-04 and no deduction is allowable subsequently.
- Deduction in respect of certain inter-corporate dividends to the extent of dividend declared.
- Exemption of any income by way of dividend, interest or long term capital gains of an infrastructure capital fund or an infrastructure capital company from investment made by way of shares or long term finance in any enterprises carrying on the business of developing, maintaining and operating infrastructure facility.

Sales Tax

Central Sales Tax (CST) - CST is 4% on manufactured goods.

Local Sales Tax (LST)

Where a sale takes place within a state, LST would be levied. Such a tax would be governed by the relevant state tax legislation. This is normally up to 15%.

Excise Duty

Excise duty on most commodities ranges between 0 to 16%. Only on seven items duty is imposed at 32%, viz., motor cars, tyres, aerated soft drinks, air conditioners, polyesters filament yarn, pan masala and chewing tobacco. Duty is charged at 30% on petrol with additional excise duty at Rs. 7 per litre. The said rates are subject to exemptions and deductions thereon as may be notified from time to time. Central VAT (CENVAT) is applicable to practically all manufactured goods, so as to avoid cascading effect on duty.

Small Scale Sector is exempted from payment of excise duty from annual production upto Rs.10 million.

Customs Duty

The rates of basic duties vary from 0 to 30%.

Salient features are:

- 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 - 5% customs duty.
- Export made with imported inputs get concessions in form of duty drawback, duty entitlement pass book scheme and advance licence.
- Many type of industries such as 100% EOU and units in free trade zone get facility of zero import duty.
- An Authority for Advance Ruling for foreign investor