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The Indian Tax System : History and Legal Framework

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Abstract

The efficiency of a country's taxation system determines the health of its economy. If the right steps are followed, it maintains revenue consistency and controls economic growth. The federal three-tier structure of our tax system is made up of the Union Government, the State Governments, and the Local Bodies. Any tax imposed that is not authorised by law or that exceeds the legislative body's authority is unconstitutional. The constitutional delegation of tax authorities established the fundamental structure for India's tax system after independence. The foundation of policy is the idea that the federal and State Governments should have separate taxing authorities. Three lists are used in Schedule VII to list the taxation-related topics. The ability to tax services was not officially recognised or delegated to any level of Government in India's constitution prior to 2003. All remaining taxing authority was granted to the Central Government, and this power served as the basis for the levying of a tax on a select few services beginning in 1994.The changes to the Indian Constitution gave the Central Government the jurisdiction to tax services. To alleviate severe fiscal strains, tax policy was used as the primary tool, and significant adjustments were implemented by a large number of nations worldwide. The internationalisation of economic activities brought about by growing globalisation served as another source of inspiration for reform. In light of the recent decision to implement GST, this essay analyses the structure of the Indian tax system, its constitutional framework, and the system's present modifications.

Key Words

Tax system, Legal framework, GST.

Introduction

The effectiveness of a country's taxation system, when implemented properly, may maintain steady revenue, promote industrial activity, and control economic expansion. The tax system can mobilise money in response to growth through effective measures, resulting in revenue growth that is just a little quicker than GDP. The three-tier federal structure of India's sophisticated tax system is made up of the Union Government, the State Governments, and the Local Bodies. The enforcement of the many levies and taxes that are common in the nation gives these three organisations their authority. These local bodies typically consist of municipalities and local councils. The Indian Constitution grants the Government the authority to impose taxes on both people and organisations. However, only a legal authority has the right to levy or collect taxes, as stated in Article 265 of the constitution. Any tax imposed must be justified by a legislation that has been approved by the legislature or the parliament. Any tax imposed by the Government that is not authorised by law or that exceeds the legislative authority may be declared unconstitutional.The Indian Constitution divides up legislative authority, including taxation, between the State Legislature and the Parliament. The paper examines the constitutional foundation, ongoing changes, and structure of the Indian tax system. Even if it is challenging to accomplish the ideal goal, changes allow us to maintain the focus on additional improvements. It is also emphasized how historical and institutional issues have influenced Indian tax policy.

Tax- Meaning and Implications

A tax may be defined as a financial burden imposed on individuals or property owners to fund the Government and a payment demanded by a governing body, depending on the definition employed. It is a compulsory contribution, exacted under the authority of the law, not a voluntary payment or donation. It can be paid in cash or in the way of its labour equivalent, and it can be direct or indirect. A direct tax is a type of fee that is assessed directly to the taxpayer and paid to the Government by the individuals (legal or natural) who are subject to it. Direct taxes are those that the taxpayer is not permitted to transmit to a third party. In contrast, an indirect tax is one which gets from the assessee (such as a retail business) that ultimately pays the tax's economic burden (such as the customer). The middleman then pays the Government for the tax money together with a tax return that is later filed. Therefore, direct taxes which are paid by the Government directly to the people (legal or natural) upon whom they are imposed,are contrasted with indirect taxes.

Past, Legal Framework, and Origin of Indian Tax System

India has had traditional taxation in place in various forms since ancient times. Agriculturists were required to pay one-sixth, one-eighth, or one-tenth of their produce, depending on their circumstances, while traders and artisans were required to pay one-fifth of their profits in silver and gold. Manu, the ancient law-giver. The Srimad Bhagvatam makes reference to the word "kara," which denotes taxation.The manifest form of a Government's identity and awareness is known as a "danda" in Sanskrit. In the ArthaShastra, Chanakya talks about "Kosha moolo danda" and says that a Government's strength comes from its treasury and its inflows. Ancient India's taxes were generally very effective, and the system's flexibility was ensured by the mix of direct and indirect taxes. The Sultans of Delhi gathered taxes during the Middle Ages in five main categories. A mansabdar received land revenue rights from the Mughal rulers in return for promises of men during battle. The British and the French were given the authority to impose taxes on behalf of the Emperor by the Treaty of Allahabad in 1765. Ancient India's taxes were generally very effective, and the system's flexibility was ensured by the mix of direct and indirect taxes. As a result, the British method of collecting land taxes was well established when the Mughal Empire fell apart after 1857. Large-scale changes and overhauls happened towards the end of the 19th century. As the leech, the calf, and the bee take their food gradually, so must the King draw from his realm, moderate annual taxes, said James Wilson, the first Finance Member of the Governor General in Council, when introducing the law establishing an income tax in the country in July 1860. As financial responsibilities grew, the tax system needed to be updated. Income taxes and other taxes became a contentious topic once the federal Government's "Diarchy" was established in 1919. In 1922, a new Income Tax Act was historically passed, establishing a full taxation system with its own administrative framework. The numerous income-tax authorities were given a particular name for the first time by the Income-tax Act of 1922. A Central Board of Revenue was established in 1924 to handle central taxes. Another paradigm shift in taxation occurred with the attainment of independence. The maintenance and development of British interests was no longer the goal of revenue collection; instead, it was for the benefit of the British people. The main direct taxes charged by the Centre are on individual and business income, with the exception of wealth tax and an agricultural income tax for which the states have the right to levy taxes. Central Excise Duty, Customs Duty, and Service Tax are the three types of indirect taxes that the Centre levies and collects. Based on the recommendations of the Central Finance Commission, which is established every five years to evaluate this sharing mechanism, a specific percentage of the taxes collected by the Centre devolve to the states. The constitutional delegation of tax authorities established the fundamental structure for India's tax system after independence. The foundation of policy is the idea that the federal and state Governments should have separate taxing authorities. Three lists are used in Schedule VII to list the taxation-related topics. The legislation that can only be passed by the state legislature and the parliament, respectively, are covered in Lists I and II. The laws that can only be passed by the federal Government are included in List III. List III of Schedule VII contains a list of the subjects on which both the State Legislature and the Parliament may simultaneously adopt laws. There is no head of taxes in the Concurrent List of the Seventh Schedule of the Indian Constitution, which is established in Lists I and II of the Internal Revenue Code.The ability to tax services was not officially recognised or delegated to any level of Government in India's constitution prior to 2003. As all When the central Government received residuary taxing authority in 1994, that power served as the foundation for the imposition of a tax on particular services. The Amendment to the Constitution of India (Article 268 A) 8 grants the Central Government the authority to levy a service tax, with the proceeds being collected and appropriated by the Central and State Governments in accordance with guidelines established by the Parliament. In 2003, a constitutional amendment specifically granted the Central Government the authority to tax services.

Reforms Carried Out –A Description

Significant improvements and numerous reforms have been implemented in numerous nations all over the world over the past 20 years. The main tool used to alleviate severe financial stress was tax policy. A serious economic imbalance acted as the primary driver in many developing nations. In other cases, substantial tax changes were required to move from a plan to a market. These tax changes were made in an effort to increase efficiency and deal with the problem of taxes replacing public enterprise revenues as the primary source of income. The economic activity that growing globalisation brought about was another factor that contributed to this. In India, tax policy has developed into a significant part of fiscal policy, which was required for the deliberate development strategy. Tax policy was the main tool used by the Indian Constitution to transfer private savings to public consumption and investment. The country's tax policy has unavoidably changed throughout time due to altering growth strategies. Early Government demands had an impact on tax policy, and efforts were made to raise taxes on those who could afford them without taking the effectiveness of the tools at their disposal into account. Given the size of the country, its complex fiscal structure, the uniqueness of the reform experience, and the challenges in calibrating reforms brought on by institutional constraints, the Indian tax reform experience can be instructive for many other nations. The Taxation Enquiry Commission's suggestions were put into reality, and the tax structure in independent India started to change. This was the first thorough assessment of the existing tax system and the creation of a system that would incorporate federal, state, and municipal taxes. Among other things, it was intended to increase savings and investment levels and transfer resources from the private to public sectors. The Indirect Taxes Enquiry Committee attempted to significantly simplify indirect taxes, but its recommendations weren't implemented until 1986. Systematic and thorough efforts to alter the federal tax system didn't start until after market-based economic reforms were introduced in 1991, when the Tax Reforms Committee (TRC) put out a framework and a roadmap for restructuring both direct and indirect taxes.With their emphasis on effectiveness and simplicity, the reforms that have been put in place since 1991 mark a substantial departure from the past. The Tax Improvements Committee made detailed recommendations for the reform of the tax system, including a new tariff structure that combined economic science with conventional wisdom. The TRC advised a variety of measures to modernise administrative and enforcement equipment, reduce exemptions and concessions, drastically streamline rules and procedures, build an appropriate information system, computerise tax returns, and enhance revenue base. The central tax system had undergone significant rationalisation and simplification by 2005, but it was still far from perfect, and the changes were neither widespread nor consistent. The TRC recommended a number of actions to update administration and enforcement tools, lessen exclusions and concessions, greatly simplify laws and procedures, create a useful information system, computerise tax returns, and increase revenue base. By 2005, there had been a major rationalisation and simplification of the central tax system, but it was still far from flawless, and the modifications had not been made consistently or widely.

The development of the Indian tax system is distinct, if not entirely unique, but having some issues in common with those of other countries. In less developed countries, tax reforms were spearheaded by the International Monetary Fund or other agencies, but India's had a strong national identity. Multilateral financial institutions did not set the direction for tax reform even though they offered some help. However, the reforms were also largely in accordance with worldwide trends and best practises. One-country-one-tax, reducing the cascading effect of taxes on taxes, increasing the tax-to-GDP ratio, reducing/eliminating tax evasion and corruption, and boosting productivity and transparency are the objectives of the most recent reform. The supply of products and services from the manufacturer to the client is subject to a single tax known as GST. The usage of input tax credits paid at each level can be done at the following stage of value addition. GST is essentially a tax that is only assessed on value added at each level. The final client will only be responsible for paying the GST assessed by the last dealer in the supply chain, with set-off benefits at all preceding levels. GST would only levy a single tax on goods and services from producer to consumer, guaranteeing that tax payments to the final consumer are transparent. As a result, there will be a decrease in overall taxation. This is because the GST system will increase the efficiency of the entire supply chain, generating profits and preventing leaks. This is expected to result in a decrease in the overall tax burden on most goods, which will benefit consumers.

Conclusion

Although tax administration has advanced, there is still more to be done to modernize the tax system. It is a constant effort to increase revenue production and reduce distortions. There should be coordinated reforms implemented at the federal, state, and municipal levels. The reduction of distortions and compliance costs should be a top priority. These new amendments to create a new direct tax system were prepared with the expectation that reduced taxes and easier regulations would boost compliance and revenue. The new direct tax code, which eliminates needless exclusions and convoluted sections, sub clauses, and disclaimers, will have an effect on everyone, from the average person to major corporations. Because a person cannot claim tax credits for taxes on his inputs if he does not pay taxes on the goods he sells, this is supposed to discourage tax evasion. Additionally, individuals will only purchase goods from sellers who have paid taxes on the goods they are selling, which would cause many currently illegal transactions to become legal, brightening India's future even further.

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