**UNIT I**

Indirect tax is a tax that can be passed on to another individual or entity. Indirect tax is generally imposed on suppliers or manufacturers who pass it on to the final consumer.

**Examples of an Indirect Tax**

Excise Duty, Customs Duty, Entertainment Tax, Service Tax, Sales Tax, Gross Receipts Tax and Value-Added Tax (VAT) are examples of Indirect taxes.

**Overview of Indirect Tax in India**

There are many indirect taxes applied by the government of India. Taxes are levied on manufacture, sale, import and even purchases of goods and services. These laws aren't also well-defined Acts from the government, rather orders, circulars and notifications are given out by relevant government bodies to this end. As such, it can be cumbersome trying to understand every feature of indirect taxes in India.

Indirect taxes are touted to be streamlined following the introduction of the uniform Goods and Services Tax (GST). The points below will help you understand more about the types of indirect taxes and where they are applicable from a consumer's perspective.

**Different Types of Indirect Taxes**

There are different types of indirect tax in India. However, after the implementation of GST, all these indirect taxes were bundled into one singular tax for the citizens of India. We will have a look at the different types of indirect tax in India:

**Service tax:** This tax is levied by an entity in return for the service provided by them. The service tax is collected by the Government of India and deposited with them.

**Excise duty:** When any product or good is manufactured by a company in India, then the tax levied on those goods is called the Excise Duty. The manufacturing company pays the tax on the goods and in turn recover the amount from their customers.

**Value Added Tax:** Also known as VAT, this type of tax is levied on any product sold directly to customer and are movable. VAT consists of Central Sales Tax which is paid to the Government of India State Central Sales Tax which is paid to the respective State Government.

**Custom Duty:** This a tax levied on the goods imported to India. Sometimes, Custome Duty is also levied on products which are exported out of India.

**Stamp Duty:** This is a tax levied on the transfer of any immovable property in a state of India. The state government in whose state the property is located charges this type of tax. Stamp tax is also applicable on all legal documents too.

**Entertainment Tax:** This tax is charged by the state government and is applicable on any products or transactions related to entertainment. Purchasing of any video games, movie shows, sports activities, arcades, amusement parks, etc. are some of the products on which Entertainment Tax is charged.

**Securities Transaction Tax:** This tax is levied during the trading of securities through Indian Stock Exchange.

**Features of Indirect Tax**

Here are the key features of indirect taxes:

**Tax liability:**

The service provider or seller pays indirect taxes to the government, and the liability is transferred to the consumer.

**Payment of tax:**

The seller pays indirect taxes to the government and the same is transferred to the consumer.

**Nature:**

Indirect taxes were initially regressive in nature, but thanks to the implementation of the Goods and Services Tax, they are now pretty progressive.

**Saving and investment:**

Indirect taxes are generally growth-oriented considering the fact that they encourage consumers to save and invest.

**Evasion:**

It is difficult to evade indirect taxes because they are now implemented directly through products and services.

**Advantages of Indirect Tax**

Here are the main advantages of indirect taxes

* **Convenience:** Indirect taxes do not burden the taxpayer and are convenient as they are paid only at the time of making a purchase. Moreover, state authorities find it convenient to levy indirect taxes because they are collected directly at the stores/factories which helps in saving a lot of time and effort.
* **Ease of collection:** Indirect taxes are easy to collect in comparison with direct taxes. Since indirect taxes are only collected at the time of making purchases, the authorities need not worry about their collection.
* **Collection from the poor:** Those who earn less than Rs.2.5 lakh p.a. are exempt from [income tax](https://www.bankbazaar.com/income-tax.html), which means that they do not contribute to the government. Since indirect taxes are charged at the point of sale, all individuals, regardless of the [income tax slab](https://www.bankbazaar.com/tax/income-tax-slabs.html) under which they fall, contribute towards the growth of the economy.
* **Equitable contributions:** Indirect taxes are directly related to the costs of products and services. What this essentially means that the basic necessities attract lower rates of tax while luxury items are charged at higher tax rates, thereby ensuring that contributions are equitable.
* **Reduce Negative Consumption**: The highest indirect taxes are placed on goods that are bad for our health, like alcohol, tobacco and other similar products. Thus, they are more expensive which helps curb the spending and consumption of such harmful commodities.

**Disadvantages of Indirect Tax**

Some of the disadvantages of Indirect Tax are given below:

* Indirect Tax charged sometimes are cumulative. This means that in a point-based transaction system, middlemen involved are likely to charge their own service tax which may result in the overall price of the product increasing.
* Indirect Tax can be regressive in nature. For example, salt tax remains the same for both poor and rich, However, if a rich person defaults the payment, then the penalties imposed will be higher as well.
* Indirect Tax are not industry friendly. Taxes are levied on raw materials and goods which in turn increases the cost of production, thus not allowing industries to expand as their competitive capacity is restricted.
* **Indirect Tax is unpredictable**: The amount of indirect taxes collected fluctuates. It is based on the buying of goods and services. As a result, it is impossible for the government to predict how much money will be raised through indirect taxes.

**Meaning of Canon of Taxation** •

By canons of taxation we simply mean the characteristics or qualities which a good tax system should possess. In fact, canons of taxation are related to the administrative part of a tax. Adam Smith first devised the principles or canons of taxation in 1776. • Even in the 21st century, Smithian canons of taxation are applied by the modern governments while imposing and collecting taxes.

**Types of Canon of taxation •**

In this sense, his canons of taxation are ‘classical’ in sense, four canons of taxation are: (i) Canon of equality or equity (ii) Canon of certainty (iii) Canon of economy (iv) Canon of convenience. • Modern economists have added more in the list of canons of taxation, these are: (v) Canon of productivity (vi) Canon of elasticity (vii) Canon of simplicity (viii) Canon of diversity.

**Canon of Equality •**

Canon of equality states that the burden of taxation must be distributed equally or equitably among the taxpayers. However, this sort of equality robs of justice because not all taxpayers have the same ability to pay taxes. • Rich people are capable of paying more taxes than poor people. Thus, justice demands that a person having greater ability to pay must pay large taxes • If everyone is asked to pay taxes according to his ability, then sacrifices of all taxpayers become equal. This is the essence of canon of equality (of sacrifice). To establish equality in sacrifice, taxes are to be imposed in accordance with the principle of ability to pay. • In view of this, canon of equality and canon of ability are the two sides of the same coin.

**Canon of Certainty •**

The tax which an individual has to pay should be certain and not arbitrary. According to A. Smith, the time of payment, the manner of payment, the quantity to be paid, i.e., tax liability, ought all to be clear and plain to the contributor and to everyone. • Thus, canon of certainty embraces a lot of things. It must be certain to the taxpayer as well as to the tax-levying authority. • Not only taxpayers should know when, where and how much taxes are to be paid. In other words, the certainty of liability must be known beforehand. Similarly, there must also be certainty of revenue that the government intends to collect over the given time period. Canon of Economy • This canon implies that the cost of collecting a tax should be as minimum as possible. Any tax that involves high administrative cost and unusual delay in assessment and high collection of taxes should be avoided altogether.

**Canon of Convenience •** Taxes should be levied and collected in such a manner that it provides the greatest convenience • not only to the taxpayer but also to the government. Thus, it should be painless and trouble-free as far as practicable. “Every tax”, stresses A. Smith: “ought to be levied at time or the manner in which it is most likely to be convenient for the contributor to pay it.”

**Canon of Productivity**

According to a well-known classical economist in the field of public finance, Charles F. Bastable, taxes must be productive or cost-effective. This implies that the revenue yield from any tax must be asizable one. Further, this canon states that only those taxes should be imposed that do not hamper productive effort of the community. • A tax is said to be a productive one only when it acts as an incentive to production.

**Canon of Elasticity**

Modern economists attach great importance to the canon of elasticity. This canon implies that a taxshould be flexible or elastic in yield. It should be levied in such a way that the rate of taxes can bechanged according to exigencies of the situation. Whenever the government needs money, it must beable to extract as much income as possible without generating any harmful consequences throughraising tax rates. Income tax satisfies this canon.

**Canon of Simplicity •** Every tax must be simple and intelligible to the people so that the taxpayer is able tocalculate it without taking the help of tax consultants. • A complex as well as a complicated tax is bound to yield undesirable side-effects. It may encourage taxpayers to evade taxes if the tax system is found to be complicated. • A complicated tax system is expensive in the sense that even the most honest educated taxpayers will have to seek advice of the tax consultants. • Ultimately, such a tax system has the potentiality of breeding corruption in the society.

**Canon of Diversity •** Taxation must be dynamic. This means that a country’s tax structure ought to be dynamic or diverse in nature rather than having a single or two taxes. • Diversification in a tax structure will demand involvement of the majority of the sectors of the population. • If a single tax system is introduced, only a particular sector will be asked to pay to the national exchequer leaving a large number of population untouched. Obviously, incidence of such a tax system will be greatest on certain taxpayers. • A dynamic or a diversified tax structure will result in the allocation of burden of taxes among the vast population resulting in a low degree of incidence of a tax in the aggregate.

By canons of taxation we simply mean the characteristics or qualities which a good tax system should possess. It refers to the guiding rules and principle to make tax collection system effective and functional. In fact, canons of taxation are related to the administrative part of a tax as it is related to the rate, amount, method and collection of a tax. Canons of Taxation are broadly classified into two heads as: A) Adam Smith’s canons of taxation B) Additional canons of Taxation A) Adam Smith’s canons of taxation: In his famous book ‘Wealth of Nation’, Adam Smith presented 4 canons of taxation which are also commonly referred to as the Main Canons of Taxation. They are as follows:

1)  Canon of equality or equity: By equality is meant equality of sacrifice. Accordingly, Canon of equality states t that the burden of taxation must be distributed equally or equitably in relation to the ability of the tax payers. Hence, to ensure canons of equality, taxes are to be imposed in accordance with the principle of ability to pay.

2) Canon of Certainty: This canon argues that the tax which an individual has to pay should be certain and not arbitrary with respects to the time of payment, the manner of payment, the quantity to be paid (tax liability) etc. In other words, Canon of Certainty states that there must be certain to the taxpayer as well as to the tax-levying authority in respect to certainty of revenue the government intends to collect over the given time period.

3)  Canon of Economy: This canon implies that the cost of collecting a tax should be as minimum as possible. Any tax that involves high administrative cost and unusual delay in assessment and high collection of taxes should be avoided altogether.

4) Canon of Convenience: According to this canon, taxes should be levied and collected in such a manner that it provides the greatest convenience not only to the taxpayer but also to the government. For example, it is convenient to pay a tax when it is deducted at source from the salaried classes at the time of paying

B) Additional canons of Taxation: Some modern writers on Public Finance such as Charles Francis Bastable (Irish classical economist:1855–1945) provided additional canons of taxation which are as follows:

1) Canon of Productivity: A tax is said to be a productive one only when it acts as an incentive to production. Accordingly, this canon implies that a tax must yield sufficient revenue and not adversely affect production in the economy.

2) Canon of Elasticity: According to this canon, an ideal system of taxation should be fairly flexible in nature in accordance with the requirement of the country. Flexible taxes are more suited for bringing social equality and achieving equal distribution of wealth.

3) Canon of Simplicity: The system of taxation should be made as simple as possible as complicated tax is bound to yield undesirable side-effects. In other words, every tax must be simple and intelligible to the people so that the taxpayer is able to calculate without any difficulty.

4) Canon of Diversity: This canon simply implies that taxation must be dynamic which means that there should be a multiple tax system of diverse nature rather than having a single tax system. A dynamic or a diversified tax structure will result in the allocation of burden of taxes among the vast population resulting in a low degree of incidence of a tax in the aggregate.

5) Canon of Expediency: This canon states that a tax should be determined on the ground of its economic, social and political expediency. For instance, a tax on agricultural income lacks social, political or administrative expediency in India and that is why the government of India had to discontinue it. From the above discussion, it follows that taxation serves the following purposes: (i) To raise revenue for the government (ii) To redistribute income and wealth from the rich to the poor people (iii) To protect domestic industries from foreign competition (iv) To promote social welfare.

**Difference Between Direct and Indirect Tax**

The fundamental categorisation of taxes is premised upon who collects the taxes from taxpayers. An overview of direct tax and indirect tax difference is given below –

|  |  |  |
| --- | --- | --- |
| Context of Differentiation Between Direct Tax vs Indirect Tax | Direct Tax | Indirect Tax |
| Imposition of [tax](https://groww.in/p/tax) | It is levied on the income or profit of a taxpayer. | An indirect tax is levied on goods and services rather than on income or profits. |
| Course of payment | Taxpayers pay it directly to the government. | Taxpayers pay it to the government through an intermediary. |
| Paying entity | Individuals and businesses | End-consumers |
| Rate of tax payment | Based on income and profits | Same for all taxpayers |
| Transferability of payment | Cannot be transferred. | Transferable |
| Nature of tax | Progressive tax, i.e., its rate increases with taxpayer’s income. | Regressive tax, i.e., its rate decreases with increase in income. |