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A Comparative Study and Analysis of Direct and Indirect Tax in India

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Abstract

Taxes are the foundation of any country's economy since they provide the funds required for welfare programs, infrastructure improvements, and public spending. Direct taxes and indirect taxes are the two main types of taxes in India. The justice principle is upheld when direct taxes are imposed on wealth and income and cannot be transferred to other people. Contrarily, indirect taxes are levied on products and services and are ultimately paid for by customers; as a result, they are frequently regressive. Both cash and labour equivalents—often but not always unpaid labour—can be used to pay taxes. India's tax system is very advanced. The central government, state governments, and local government entities make up the three primary tiers of India's tax structure. These local bodies typically consist of municipalities and local councils. The Indian Constitution grants the government the authority to tax both people and businesses. But according to the constitution, only the government has the ability to impose taxes. Any tax that is imposed must be supported by legislation that has been approved by the parliament or legislature. The direct and indirect taxes in the Indian setting are thoroughly examined in this paper. It examines their composition, traits, management systems, and relative advantages and disadvantages. The study ends by outlining present issues and offering legislative solutions for an improved, more just, and growth-oriented tax structure in India.

Key words: Direct tax, indirect tax, Indian government, financial year, policy, economy

Introduction

One way to characterize a tax is as a "monetary burden imposed on people or property owners to fund the government; a payment extracted by legislative authority". A fee is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority. One of the government's main and most significant sources of funding is taxes. Tax revenue is used by the government to fund a number of initiatives aimed at the country's advancement [1]. The main objective of the government is to raise enough money to cover all of its expenses for administration, related services, and public spending. The Indian tax system has been adjusted in accordance with needs since independence in order to advance our economy [2]. Taxes are levied by governments to collect money from the sale of products and services as well as from income [3].

The main objective of the government is to raise enough money to cover all of its expenditures, administrative costs, and related services [4]. Three layers make up India's federal tax system: the State Government, the Central Government, and local governments like the municipal Government.

According to Article 256 of the Constitution, no other authority is allowed to collect taxes from other people [5]. The primary levies that the Union Government can impose are the following: Customs duties, Central Excise and Sales Tax, Service Tax, and Income Tax (with the exception of the tax on agricultural income, which is levied by the State Governments). Sales tax (tax on intrastate sales of goods), stamp duty (tax on property transfers), state excise (tax on the production of alcoholic beverages), land revenue (tax on land used for agricultural and non-agricultural purposes), entertainment tax, and tax on professions and callings are the main taxes imposed by state governments. The Local Bodies have the authority to impose taxes on markets, Octroi (a tax on the entry of products for use or consumption within their jurisdiction), taxes on properties (buildings, etc.), and taxes on users of utilities such as drainage and water supplies [6].

India has made significant changes to its direct and indirect tax systems over the years in an effort to streamline the tax code, boost openness, and enhance compliance. The introduction of the Goods and Services Tax (GST) in 2017, which consolidated numerous indirect taxes and sought to establish a single national market, was one of the biggest reforms. According to the [7] paper, the Goods and Services Tax is unquestionably a long-term plan that will propel the advancement and development of a nation like India. In order to make up for the losses, the study report [8] on India's tax structure and how it affects corporations and individuals in the country recommends raising direct

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taxes on the wealthiest and decreasing reliance on indirect taxes. The authors added that it's important to look into corporate tax avoidance strategies including transfer pricing.

This research article emphasis the both direct and indirect tax system in India by giving understanding of fundamentals, tax structure, significance of each aspect in tax and challenges associated with both types of tax.

1. Classification of Tax in India

The well-defined tax system of India, a mixed economy with a federal framework, is intended to mobilize resources from both individuals and enterprises in an equitable manner. Direct taxes and indirect taxes are the two main categories into which the Indian tax system is divided. The basis for this classification is the type of tax incidence and the way the tax burden is distributed. Depending on their wealth or income, people and organizations are subject to direct taxes. It is impossible to transfer the cost of these taxes to another person. Goods and services are subject to indirect taxes, which are collected from customers by middlemen such as vendors or service providers.

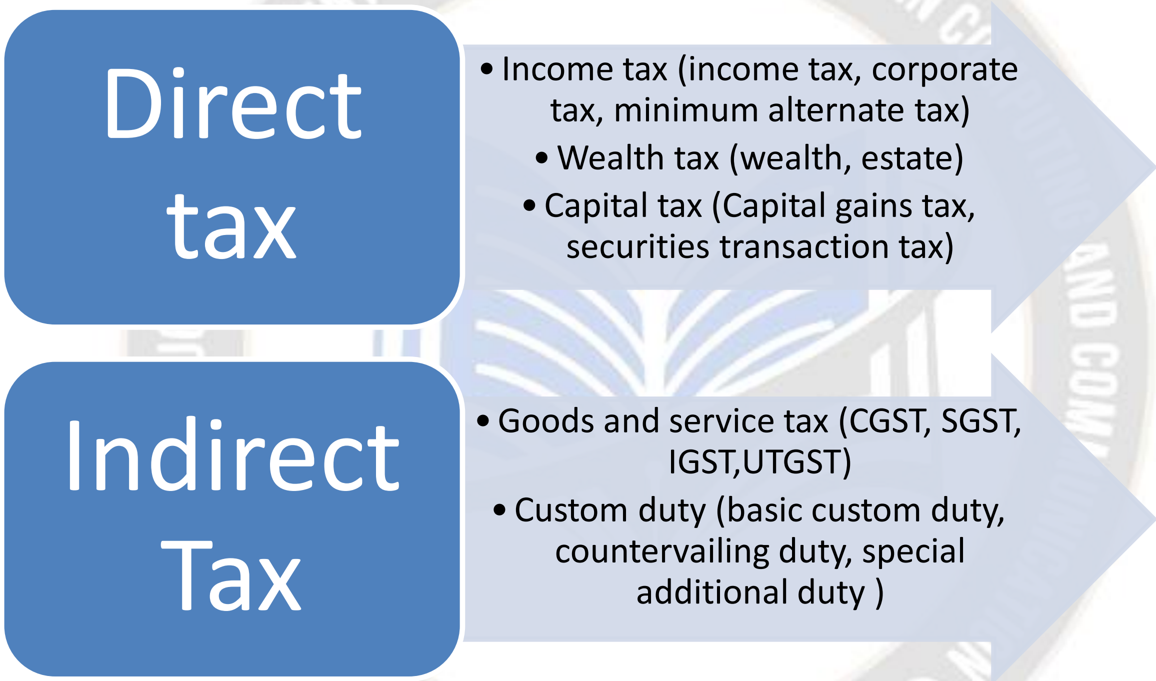

Fig.1 Classification of Tax system in India

The major categories of tax system in India under direct tax are: income tax, wealth tax and capital tax. However, wealth tax is now no more existing in current financial years. In income tax there are income tax, corporate tax & minimum alternate tax exist.

○ **Income tax:** Income tax is a direct tax levied by the Indian government on the earnings of individuals, businesses, limited liability partnerships, Hindu Undivided Families (HUFs), and other non-corporate entities. The Central Board of Direct Taxes (CBDT) oversees its administration, which is regulated by the Income Tax Act of 1961. assessed yearly in accordance with the revenue from the prior year. Depending on their residence status, this applies to both residents and non-residents.

Depending on residence status, this applies to both residents and non-residents. This tax assessed yearly in accordance with the revenue from the prior year. Tax uses a progressive slab system, meaning that tax rates rise in proportion to an individual's income.
Types of income tax payers are as under.

- Individuals like salaried, professionals, self-employed persons
- HUFs
- Firms and LLPs
- Association of Persons
- Body of Individuals
- Local Authorities
- Artificial Juridical Persons

- **Corporate tax:** According to the Income Tax Act of 1961, corporate tax is a direct tax imposed on the net income or profit of businesses, both local and foreign. The companies can impose tax.

Domestic companies based in India and registered there is part of corporate tax. Foreign

businesses that are incorporated outside of India yet generate revenue there.

- **Minimum alternate tax**: Section 115JB of the Income punish Act has a measure known as the Minimum Alternate Tax (MAT), which is intended to punish businesses that fail to pay taxes by displaying zero or very little taxable income in spite of making large profits.

Some businesses report zero taxable income under the regular procedures but display book profits in their financial accounts because they have taken advantage of exemptions and deductions. MAT makes sure these businesses pay a minimal tax based on their book profits in order to bring them under the tax net.

- **Capital tax:** Capital Gains Tax is a direct tax levied on the profits or gains arising from the sale or transfer of a capital asset. It is governed under Sections 45 to 55 of the Income Tax Act, 1961. The term “capital gains” refers to the profit made when a capital asset is sold for a price higher than its purchase cost. These gains are treated as income and taxed in the year in which the transfer takes place.

Capital tax includes real estate (land, buildings), Shares and securities, Bonds and mutual funds, Gold and other precious metals and intellectual property, jewellery, artwork.

- **Goods and service tax:** In India, the delivery of goods and services is subject to the Goods and Services Tax (GST), a comprehensive indirect tax. It took the place of a convoluted system of several indirect taxes that the federal and state governments had previously imposed on July 1st, 2017. The final consumer bears the tax burden even though the GST is a destination-based, multi-stage, value-added tax that is collected at every point of the production and distribution chain.

The GST is a historic tax reform in India that has improved the indirect tax structure's efficiency, consistency, and openness. It has mainly simplified tax administration and compliance, despite early implementation challenges. To reach its full potential, stakeholder participation and ongoing upgrades are essential.

2. Structure of Direct Tax System

Numerous studies on economic growth have been spurred by the global partnerships' support of the Sustainable growth Goals (SDG). In addition to fighting climate change and preserving forests and seas, eradicating poverty will require initiatives to improve health and education, lessen inequality, and promote economic growth. As a result, the UN has set 17 development goals that need to be accomplished by 2030.

Ensuring long-term, equitable, and sustainable economic growth—which includes full and productive employment for everyone—is the eighth objective. To accomplish the goal, full employment and sustainable economic growth are necessary. It is possible to achieve full and productive employment and GDP growth of at least 7% annually in the least developed nations by 2030.

Authority	Role
CBDT (Central Board of Direct Taxes)	Policy-making and administration of direct taxes.
Income Tax Department	Implementation of the Income Tax Act, assessment, and tax collection.
Assessing Officers (AOs)	Assess income tax returns, issue notices, and conduct audits.
Appellate Authorities	Handle disputes and appeals – CIT(A), ITAT, High Courts, Supreme Court.

Table:1 Structure of direct tax

The Central Board of Direct Taxes (CBDT), a division of the Department of Revenue, Ministry of Finance, Government of India, is in charge of overseeing the administration and enforcement of direct taxes in the country. In order to guarantee effective tax policy design, execution, assessment, collection, and grievance redress, the structure is very methodical and hierarchical.

Type of Tax	Taxpayer Type	Basis of Taxation	Tax Rate / Features
Income Tax	Individuals, HUFs, Firms	Total Income	Slab rates / fixed rates
Corporate Tax	Companies	Net Profits	15% / 22% / 25% / 30%
MAT / AMT	Companies / LLPs	Book or adjusted income	15% / 18.5% (credit available)
Capital Gains Tax	All taxpayers	Gain from capital assets	10% / 15% / 20%
STT	Traders and investors	Value of securities transactions	Predefined rates
Dividend Tax	Shareholders	Dividend received	Taxed as per slab rate
Gift Tax	Individuals, HUFs	Gifts received	Taxable above ₹50,000 (with exceptions)

Table:2 Direct tax characteristics

3. Structure of Indirect Tax in India

Taxes imposed on products and services as opposed to income or profits are known as indirect taxes. These taxes are eventually paid by the final customers after being collected by middlemen (such as vendors or service providers). India's indirect tax system has changed significantly since the Goods and Services Tax (GST) went into effect on July 1, 2017, when it replaced several central and state taxes with a single tax structure.

Type of Tax	Levied By	Applicable On	Key Features
CGST	Central Government	Intra-state goods/services	Shared equally with SGST; central revenue
SGST	State Government	Intra-state goods/services	Revenue goes to respective state government
IGST	Central Government	Inter-state or imports	Collected by Centre, then distributed between Centre & State
UTGST	Union Territory	Intra-UT supplies	Applies in UTs like Delhi, Chandigarh, Andaman & Nicobar
Customs Duty	Central Government	Imports/exports of goods	Includes BCD, CVD, anti-dumping, and safeguard duties
Excise Duty	Central Government	Select goods like petroleum, tobacco	Not subsumed under GST
Stamp Duty	State Government	Property and legal documents	Not part of GST; varies by state
Other State Levies	State Governments	Electricity, vehicles, local bodies	Not under GST; remain independently administered

Table:2 Structure of indirect tax

Since the GST largely unified India's indirect tax system, compliance has become easier, transparency has increased, and the tax base has grown. The GST system is a hybrid one, though, as some legacy taxes, such as state levies, petroleum product excise, and customs duty, continue to exist outside of it.

4. Tax System Reforms

➢ Direct Tax Reforms

Over the years, India's tax system has experienced substantial structural changes to both direct and indirect taxes. The goals of these reforms have been to increase efficiency and transparency, increase compliance, expand the revenue base, and simplify the tax structure.

Rationalization of Tax Rates: Periodically, slab rates have been modified to improve system equity. introduction of a new, streamlined tax system with lower rates and no exclusions or deductions (Section 115BAC, FY 2020–21).

Reduction in Corporate Tax: Corporate tax rates were drastically reduced in 2019: 15% for new manufacturing firms and 22% for domestic businesses (without exemptions).

Expansion of PAN and Aadhaar Integration: PAN and Aadhaar must be linked in order to track financial transactions and prevent duplication. enhanced verification and compliance with taxes.

Direct Tax Code (DTC) Proposal: Iintended to take the place of the Income Tax Act of 1961, but it is currently being considered. suggests making tax laws clearer, simpler, and more unified.

➢ Indirect Tax Reform

Implementation of Goods and Services Tax (GST) – 2017: A complex network of indirect taxes, including VAT, CST, Excise Duty, Service Tax, Entry Tax, and Octroi, was replaced by this historic reform. unified Indian market. Tax cascades (tax on tax) were eliminated.

Input Tax Credit (ITC) System: Reduced the overall tax burden by enabling companies to claim credit for input taxes paid. promotes compliance and appropriate documentation.

Composition Scheme for Small Businesses: Reduced tax rates and easier compliance under an optional plan. intended for small taxpayers and MSMEs.

5. Challenges of Tax System

India's tax system still faces a number of structural, administrative, and compliance-related issues in spite of multiple reforms in both direct and indirect taxation. These problems restrict revenue mobilization, impede effective tax collection, and frequently deter voluntary tax compliance.

- It is challenging to monitor revenue and enforce compliance when there is a high level of informal economic activity.
- Tax evasion results from the use of shell corporations, fictitious invoices, and cash transactions.
- India still has a low tax-to-GDP ratio (around 11–12%) when compared to several affluent nations (25–30%).
- Limited tax base, as only a small percentage of people (about 6–7 crore active taxpayers) pay income taxes.
- Tax evasion burdens law-abiding taxpayers and lowers government revenue.

Even while India has made great strides in tax reform, particularly with the introduction of the GST and digital tax systems, several obstacles still exist. To successfully address issues, rules must be made simpler and evasion must be enforced more strictly.

6. Conclusion

From a complicated and disjointed structure to a more modern and coherent framework, the Indian taxation system has experienced a transition. Different ways to revenue collection and varying effects on the economy and citizens are reflected in the distinction between direct and indirect taxes. Direct taxes, like corporation and income taxes, are progressive and play a major role in lowering economic disparity. Through initiatives like faceless assessments and PAN-Aadhaar integration, they have attempted to increase transparency, rationalize rates, streamline procedures, and broaden the taxpayer base. However, the implementation of the Goods and Services Tax (GST) in 2017 brought about a significant overhaul of indirect taxes. In order to simplify compliance, lessen the cascading effect of taxes, and establish a single national market, the GST has replaced numerous state and central levies with a single, unified tax framework. Still, there are issues including categorization disputes, delayed refunds, and small business compliance obligations.

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