TAXATION IN A HISTORIC PERSPECTIVE

Dr. Johnson V.

Associate Prof. and Head, P G Department of Commerce, Pavanatma College Murickassery.

Abstract

India has registered remarkable growth since the inception of economic reforms in 1991. It has become increasingly integrated with the global economy. Exports have become an important element of India's economic growth. Even though the country has moved on the path of tax reforms since the mid-1980s there are various issues which need to be addressed so as to boost productivity and international competitiveness of the Foreign Trade. Sales of services to the consumers are not appropriately taxed with many types of services escaping the tax net. Intermediate purchases of inputs by the business firms do not get full offset and part of non-offset taxes may get added up in prices quoted for exports thus making exporters less competitive in world markets. The ongoing tax reforms on moving to a goods and services tax would impact the national economy, international trade, firms and the consumers.

The present paper attempts a theoretical review of the subjects in general. The broad objective of the paper is to study the impact of introducing comprehensive goods and services tax (GST) on economic growth and international trade. It also sets focus on changes in rewards to the factors of production and output, prices, capital, employment, efficiency and international trade at different levels.

Key Words: tax, trade, economy, world markets

Introduction

Taxation is the crown jewel of public finance. The history of taxation dates back to time immemorial and it is not a recent development by any account. Emperors, kings and heads of states levied taxes or duties to pay for wars or the upkeep of castles and palaces or other public projects. A thorough research on the history of taxation system shows that taxes were levied on either on the sale and purchase of merchandise or livestock, though the process of levying and the manner of tax collection were unorganized. However all historical leaders and head countrymen collected taxes to run its authority, to meet military needs and civil expenditure for the overall welfare of the subjects.

The word tax is derived from the Latin word 'taxare' meaning to estimate. "A tax is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority and is any contribution imposed by government whether under the name of toll, tribute, impost, duty, custom, excise, subsidy, aid, supply, or other name."[1]

The world scenario

The first known system of taxation was in Ancient Egypt around 3000 - 2800 BC. Records from that time show that the pharaoh would conduct a biennial tour of the kingdom, collecting tax revenues from the people. Other records are granary receipts on limestone flakes and papyrus. Early taxation is also described in the Bible. The Genesis states "But when the crop comes in, give a fifth of it to Pharaoh. The other four-fifths you may keep as seed for the fields and as food for yourselves and your households and your children." Joseph was telling the people of Egypt how to divide their crop, providing a portion to the Pharaoh. A share (20%) of the crop was the tax.

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To the Athenians in Greece, war was a lifestyle, and a pricey one at that. As such, Athenians taxed their citizens for war costs with a tax they called "eisphora." The most historic factor of this tax was that it exempted no one, which many consider the first democratic taxation system, as after the wars the money was often refunded to the people . Taxes called "portoria" were first levied in Rome on imports and exports to the city. Caesar Augustus, who is now considered a genius tax strategist of his time, gave individual cities the job of collecting taxes. He also raised sales taxes on slaves from 1% to 4%, and created a tax to raise retirement funds for soldiers of the army. The occupation of the Roman Empire may have sparked the flame for first taxes in England. Before the French Revolution, civil unrest laid heavily on the shoulders of high taxes for lower classes. While clergymen and nobles were exempt to taxes, peasants and regular wage earning workers were not.

The history of taxation in the United States began when it was composed of colonies ruled by the British Empire, French Empire, and Spanish Empire. After independence from Europe the United States collected poll taxes, tariffs, and excise taxes. The United States imposed income taxes intermittently until 1895 when unapportioned taxes on interest, dividends and rents were ruled unconstitutional. The advent of the 16th Amendment to the United States Constitution modified the apportionment requirement in 1913, and since then the income tax has become one of the means of funding the Federal Government.

The Indian Context

In India, the tradition of taxation has been in force from ancient times. It finds its references in many ancient books like *'Manu Smriti'* and '*Arthasastra*'. There was a perfect admixture of direct taxes with indirect taxes and they were varied in nature. India's history of taxation suggests existence of a large and composite taxable population. With the advent of the moguls in India the country witnessed a sea of change in the taxation system of India. Although, they also practiced the same norm of taxation it was more homogeneous in structure and collection.

The period of British rule in India witnessed some remarkable changes in the whole taxation system of India. Although, it was highly in favor of the British Government and its exchequer it incorporated modern and scientific method of taxation tools and systems. Salt has been taxed in India for centuries. However, in 1835 the British East India Company raised the import taxes drastically after they began to impose rule over Indian provinces. The salt tax was raised and lowered by multiple leaders and events, and was not repealed until 1946. In 1922, the country witnessed a paradigm shift in the overall taxation system; setting up of administrative system and taxation system was first done in the history of taxation in India. The period thereafter witnessed rapid growth and modernization of the Indian taxation system

Systematic reforms of the tax system at the central level started only after market based economic reforms that began in 1991. The Tax Reforms Committee (TRC; India, 1991) laid out a framework and a roadmap for reform of direct and indirect taxes as a part of the structural reform process, following the unprecedented economic crisis. The paradigm shift in tax reforms adopted by the TRC was in keeping with the best practice approach of broadening the base, lowering marginal tax rates, reducing rate differentiation, simplifying the tax structure and adopting measures to make the administration and enforcement more effective.

The important proposals put forward by the TRC included reduction in the rates of all major taxes, i.e., customs, individual and corporate income taxes and excises to reasonable levels, maintain progressivity but not such as to induce evasion. The TRC recommended a number of measures to broaden the base of all the taxes by minimizing exemptions and concessions, drastic simplification of laws and procedures, building a proper information system and computerization of tax returns, and revamping and modernization of administrative and enforcement machinery ‘

Recent reforms in the tax system

The recent reforms are, in fact, a continuation of the reforms initiated in 1991. The overall direction has been to broaden the tax bases, reduce the rates, reduce rate differentiation and make the tax system simple and transparent. There has been considerable simplification and rationalization of union excise duties as well. Besides reduction in the number of rates, the tax has been progressively converted from specific into ad valorem levy. The facility of providing credit on input taxes under the CenVAT too has been progressively extended to cover about 80% of the taxed commodities.

Emergence of VAT

The most important reform initiative in the case of the States is the replacement of the cascading type sales tax with the state level VAT. There was a burden of multiple taxation in the pre-existing Central excise duty and the State sales tax systems. Inputs were first taxed, and then after the production of finished commodity which already includes input tax, output was taxed again. This has been causing burden of multiple taxation with cascading effects. Moreover, in the sales tax structure, when there was also a system of multi-point sales taxation at subsequent levels of distributive trade, then along with input tax load, burden of sales tax paid on purchase at each level was also added, thus aggravating the cascading effect further. This was done away with the introduction of VAT in the Centre and in the States.

In case of VAT, a deduction is made from the overall tax burden for input tax. This set off relieves from a substantial amount tax burden not only for input tax paid but also for tax paid on previous purchases. Thus, with VAT, the problem of multiple tax and related burden of cascading effect gets removed. Furthermore, since the benefit of set-off can be obtained only if tax is duly paid on inputs (in the case of Central VAT), and on both inputs and on previous purchases (in the case of State VAT), there is a built-in check in the VAT structure on tax compliance in the Centre as well as in the States, with expected results in terms of improvement in transparency and reduction in tax evasion

In India, VAT was introduced at the Central level for a selected number of commodities in terms of MODVAT on March 1, 1986, and gradually all commodities were included by 2002-03. In 2004-05 the Centre was empowered to levy taxes on services, and services were also brought under the purview of CENVAT in 2004-05.

The first preliminary discussion on State-level VAT took place in a meeting of Chief Ministers convened by Dr. Manmohan Singh in 1995. Thereafter, in a significant meeting of all the Chief Ministers, convened on November 16, 1999, two important decisions were taken. First, to do away with the unhealthy sales tax “rate war” among the States and harmonize sales tax rates by implementing uniform floor rates of sales tax for different categories of commodities from January 1, 2000. For implementing these decisions, a Standing Committee of State Finance Ministers was formed which was then made an Empowered Committee of State Finance Ministers

Steps were also taken for necessary training, computerization and interaction with trade and industry. While these preparatory steps were taken, the Empowered Committee got a significant support from the central government in providing Central financial support to the States in the event of loss of revenue in transitional years of implementation of VAT. As a consequence of all these steps, the States started implementing VAT beginning April 1, 2005 and now all the States and Union Territories have implemented VAT .

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Direct Taxes Developments

Over the years, direct taxes have had a major impact on economic policies, creation of savings and the trend of investment. There was no proportion in terms of the impact of direct taxes on the economy and there relative share in total tax revenues. The system of direct taxes was very much complex and inefficient because of the combination of high marginal rates of personal income and wealth taxes. The corporate tax rate was pretty high. This all lead to large scale tax evasion. However over the years, the government has tried to streamline these taxes and have also gradually reduced the direct tax rates. Several incentives and exemptions have been given to encourage the taxpayers to make prompt payment of these taxes and to reduce tax evasion. Easy payment of taxes has also been enhanced by giving options of electronic filing of returns and other online facilities to the taxpayers.

Main Direct Tax reforms in 2009 are IT Return forms to be more user friendly, Centralized tax processing centre at Bangalore, New direct tax code proposed to be brought in 45 days and so on. The reforms with regard to personal income tax will involve further simplification of the tax system. This includes withdrawal of tax exemptions and concessions given for specified activities, abolition of surcharge and further simplification of the tax. On the corporation tax, base broadening involves getting rid of the tax preferences.

Developments in indirect taxes

As per the Ministry Of Finance there has been significant development in planning for introducing the goods and services tax (GST) from April 1 2016.The sales tax model will have a Central GST and State GST.As a first step the rate of central sales tax (CST) has been reduced to 2 per cent w.e.f. 1st June 2008.The general rate of central value added tax (CENVAT) has been decreased from 16 per cent to 14 per cent across all goods. With regard to import duties, the reform will have to move in the direction of further reduction and unification of the rates. As most non-agricultural tariffs fall between zero and 15%, a uniform tariff of 10% would considerably simplify and rationalize the systems.

Major Milestones in Indirect Tax reform

1974 Report of LK Jha Committee suggested VAT

1986 Introduction of a restricted VAT called MODVAT

1991 Report of the Chelliah Committee recommends VAT/Goods & Services Tax (GST) and recommendations accepted by Government

1994 Introduction of Service Tax

1999 Formation of Empowered Committee on State VAT

2000 Implementation of uniform floor sales tax rates (1%, 4%, 8% &12%)

2003 VAT implemented in Haryana in April, 2003

2004 Significant progress towards a Central VAT/ Sept 2004 GST – Integration

2005-06 VAT implemented in 26 more states

2007 First GST Study Released By Mr.P.Shome in Jan 2007

2007 FM announces for GST in Budget Speech

2007 CST Phase out Starts in April 2007

2007 Joint Working group formed by EC in May 2007

2007 WG submits its report in November 2007

2008 EC finalizes its view on GST structure in April 2008

2014 GST proposed to be implemented from 1.4.2016

WAY FORWARD TO GST

Goods and Services Tax also known as the Value Added Tax (VAT) or Harmonized Sales Tax (HST) was first devised by a German economist during the 18th century. He envisioned a sales tax on goods that did not affect the cost of manufacture or distribution but was collected on the final price charged to the consumer. Goods and Services Tax is a broad based and a single comprehensive tax levied on goods and services consumed in an economy. GST is levied at every stage of the production-distribution chain with applicable set offs in respect of the tax remitted at previous stages. It is basically a tax on final consumption.

Despite the success of VAT, there are still certain shortcomings in the structure of VAT both at the Central and at the State level. The shortcoming in CENVAT lies in non inclusion of several Central taxes in the overall framework of CENVAT, such as additional customs duty, surcharges, etc. and thus keeping the benefits of comprehensive input tax and service tax set-off out of reach for manufacturers/dealers. Moreover, no step has yet been taken to capture the value added chain in the distribution trade below the manufacturing level in the existing scheme of CENVAT.

Background of Goods and Services Tax (GST) in India

The Kelkar Task Force on implementation of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 had pointed out that although the indirect tax policy in India has been steadily progressing in the direction of VAT principle since 1986, the existing system of taxation of goods and services still suffers from many problems. The tax base is fragmented between the Centre and the States. Services, which make up half of the GDP, are not taxed appropriately. In many situations, the existing tax structure has cascading effects. These problems lead to low tax-GDP ratio, besides causing various distortions in the economy. In this context, the Kelkar Task Force had suggested a comprehensive Goods and Services Tax (GST) based on VAT principle.

The introduction of GST at the Central level will not only include comprehensively more indirect Central taxes and integrate goods and service taxes for the purpose of set-off relief, but may also lead to revenue gain for the Centre through widening of the dealer base by capturing value. The existing State-level VAT structure also has certain weaknesses. For instance there are even now, several taxes which are in the nature of indirect tax on goods and services such as luxury tax, entertainment tax, etc., and yet not subsumed in the VAT. Moreover, in the present State-level VAT scheme, CENVAT load on the goods remains included in the value of goods to be taxed under State VAT, and contributing to that extent a cascading effect on account of CENVAT element. This CENVAT load needs to be removed. The GST at the Central and at the State level will thus give more relief to industry, trade, agriculture and consumers through a more comprehensive and wider coverage of input tax set-off and service tax setoff, inclusion of several taxes in the GST and phasing out of CST.

GST is not simply VAT plus service tax but an improvement over the previous system of VAT and disjointed service tax. However, for this GST to be introduced at the State level, it is essential that the States should be given the power of levy of taxation of all services. This power of levy of service taxes has so long been only with the Centre. A Constitutional Amendment will be made for giving this power also to the States.

The GST at the Central and at the State level will thus give more relief to industry, trade, agriculture and consumers through a more comprehensive and wider coverage of input tax set-off and service tax setoff, inclusion of several taxes in the GST and phasing out of CST. With the GST being properly formulated by appropriate calibration of rates and adequate compensation where necessary, there may also be revenue/resource gain for both the Centre and the States, primarily through widening of tax base and possibility of a significant improvement in tax-compliance. In other words, the GST may usher in the possibility of a collective gain for industry, trade, agriculture and common consumers as well as for the Central Government and the State Governments. The GST may, indeed, lead to the possibility of collectively positive-sum game. Keeping this significance of GST in view, an announcement was made in the Union Budget to the effect that GST would be introduced from April 1, 2016.

Benefit of Goods and Services Tax

1 Eliminates cascading effect of taxes across all supply chain by reducing cost of doing business and makes the economy competitive.

2 Eliminates multiplicity of taxes, rates, exemptions and exceptions.

3 Eliminates dual taxation of the same transaction (e.g. VAT & Service tax on EPC (engineering, procurement and construction)contracts.

4 Reduces cost of production.

5 Achieves, uniformity of taxes across the territory, regardless of place of manufacture or distribution.

6 Provides, greater certainty and transparency of taxes.

7 Ensures tax compliance across the economy.

8 Augments and creates buoyancy in the economy.

Conclusion

The implementation of GST is a challenging but highly promising proposition in a country like India which has to address the ever growing phenomenon of revenue expenditure mismatch, a serious threat to fiscal robustness and sustainable development. It will also improve the international cost competitiveness of native goods and services. Further it will also encourage an unbiased tax structure that is neutral to business processes and geographical locations. Once implemented, the proposed GST model would herald a new era in the indirect tax regime of India, subsuming and superseding all indirect taxes into a unified and simplified system a step further above VAT system in addressing the effect of cascading and pyramiding of taxes and also enhancing the tax base.

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