### Lecture



Class: FY BSc

**Subject:** Business Finance - 1

**Subject Code: PUSASQF 1.4** 

Chapter: Unit 1 Chp 3

**Chapter Name:** Indian & International Tax System



## Topics to be covered

- 1. What is Tax?
- 2. Types of Tax
- 3. Personal Taxation
- 4. Capital Gains Tax
- 5. Corporate Income Tax
- 6. International Taxes
- 7. Double Taxation Relief

## 1 What is Tax?



**Taxes** are mandatory contributions levied on individuals or corporations by a government entity—whether local, regional or national.

### Why pay Tax?

- To help fund public works and services—and to build and maintain the infrastructure used in a country—a government usually taxes its individual and corporate residents. The tax collected is used for the betterment of the economy and all who are living in it.
- During the 19th century the prevalent idea was that taxes should serve mainly to finance the government. In earlier times, and again today, governments have utilized taxation for other than merely fiscal purposes.
- One useful way to view the purpose of taxation, attributable to American economist Richard A. Musgrave, is
  to distinguish between objectives of resource allocation, income redistribution, and economic stability.
  (Economic growth or development and international competitiveness are sometimes listed as separate goals,
  but they can generally be subsumed under the other three.)



## 2 Types of Taxes

### **Direct Taxes**

 It is a tax levied directly on a taxpayer who pays it to the Government and cannot pass it on to someone else.

### **Indirect Taxes**

 It is a tax levied by the Government on goods and services and not on the income, profit or revenue of an individual and the liability to pay taxes can be shifted from one taxpayer to another.





## 2 Types of Taxes

### **Direct Taxes**

- Income Tax
- Wealth Tax
- Capital Gains
- Property Tax
- Gift Tax
- Inheritance Tax
- Stamp Duty

### **Indirect Taxes**

- GST
- VAT
- Excise
- Octroi
- CST
- Customs Duty
- Service Tax



#### What can be taxed?

- Personal taxation is typically levied on all of the financial resources of an individual such as:
- Salaries
- Profits from Business / Profession
- Inherited Wealth
- ➤ Investment Gains
- Capital Gains
- ➤ Other Income Sources Rent, etc.





#### How can it be collected?

- **Tax of Cash Flows** Taxation is limited to cashflows, since these are indicative of cash being available to finance the tax payable
- **Taxing in Arrears** Tax is payable as income is earned or accrued and not dependent to whether actual cash flows have been realized
- Taxing Once Revenue flows are taxed only once in the hands of the recipients.

"Pay as you Earn" (PAYE) Scheme

Most employed people pay tax weekly or
monthly directly from their salary or wages

Tax Deducted at Source (TDS) or Withholding Taxes

Advance Tax

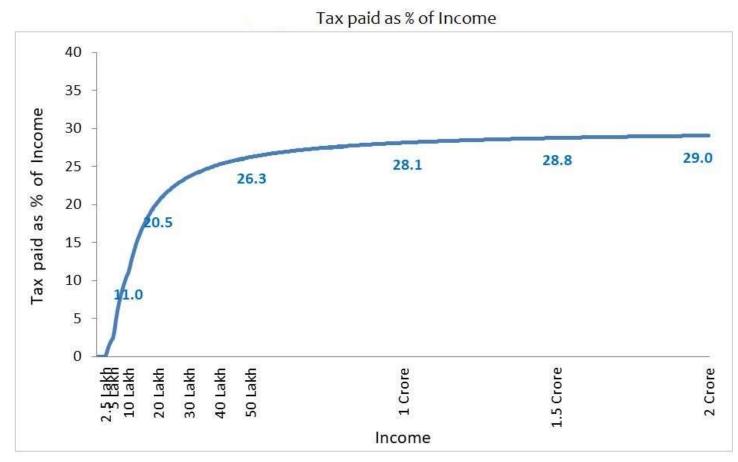


#### **Tax Rates vs Tax Slabs**

Factors that determine the tax rates for different income slabs are:

- Slab Rates
- Flat / Proportional Rate
- Progressive Tax Rates
- Regressive Tax Rates
- Surcharges

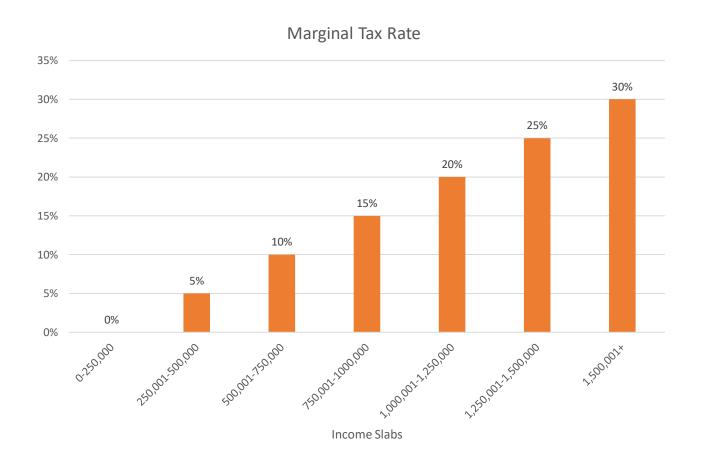
The adjoining graph shows tax rates for different income slabs



The following table shows tax rates for different income slabs in India:

Income Tax Slab	Tax Rates As Per New Regime	
₹0 - ₹2,50,000	Nil	
₹2,50,001 - ₹ 5,00,000	5%	
₹5,00,001 - ₹ 7,50,000	₹12500 + 10% of total income exceeding ₹5,00,000	
₹7,50,001 - ₹ 10,00,000	₹37500 + 15% of total income exceeding ₹7,50,000	
₹10,00,001 - ₹12,50,000	₹75000 + 20% of total income exceeding ₹10,00,000	
₹12,50,001 - ₹15,00,000	₹125000 + 25% of total income exceeding ₹12,50,000	
Above ₹ 15,00,000	₹187500 + 30% of total income exceeding ₹15,00,000	

The following graph shows tax rates for different income slabs in India:





### **Calculating Taxable Income:**

• Government may allow adjustments to total income to arrive at taxable income, i.e. that part of income subject to tax. The government might exempt some sorts of income and expenditure from tax, so there might be some tax-free income and tax-free expenditure.

#### $Taxable\ Income =$

 $Income\ Earned-Taxable\ Income\ -Tax\ free\ Expenditure+Income\ in\ Kind+Investment\ Income-Allowances$ 

Tax Free Income (Agriculture Income, PF Interest, Dividend)

Tax Free Expenditure (Life Insurance Premium, S. 80C)

Income in Kind (fringe benefits, gifts, etc.)

Investment Income

Allowances
(age related
benefits,
standard
deductions,
allowable
expenses)



### **What is Capital Gain?**

- A Profit from the sale of property or an investment
- Chargeable gains normally fall into the tax year of assessment during which the gain is realized so that, again, the funds to pay the tax should be available



### Exceptions

For example, in the UK the following assets are free from capital gains tax:

- private motor cars
- a main private residence
- foreign currency obtained for personal use
- British Government securities and other qualifying fixed-interest stocks
- small tangible moveable assets (or chattels) worth less than £6,000 (eg furniture, jewellery, paintings, antiques etc).

Transactions between spouses (or civil partners) do not normally attract capital gains tax.



#### How to avoid tax on LTCG

There are provisions under the Income-tax Act to save tax on long-term capital gains (LTCG) arising from transfer of capital assets like real estate, stocks, gold, bonds and so on.









Particulars	Section 54	Section 54 EC	Section 54 F
Capital gains arising from	Residential property	Residential property	Assets other than residential property
Exemption	LTCG tax can be saved by reinvesting the gains in maximum of two residential properties*	LTCG tax can be saved by investing in specified bonds	LTCG tax can be saved by buying a residential property
Time limit for reinvest- ment of LTCG	Can be adjusted against the house purchased in last one year or two years from the date of sale; three years in case the seller wishes to construct a house with the LTCG amount	LTCG amount should be invested in bonds within six months from the sale date	Can be adjusted against the house purchased in last one year or two years from the date of transfer of the old house; three years in case seller wishes to construct a house with the LTCG amount
CGAS applicability	Yes	No	Yes

Capital Gains = Sale Price - Cost of Purchase - Costs associated with Purchase - Expenditure to Enhance the Asset

#### **Indexation Allowance**

- Allowances to remove the inflationary element of any gain, or to encourage individuals to retain assets for a longer tenure.
- In the UK, no allowances are made for the effect of inflation on the value of assets.

### Capital losses can normally be offset against capital gains.

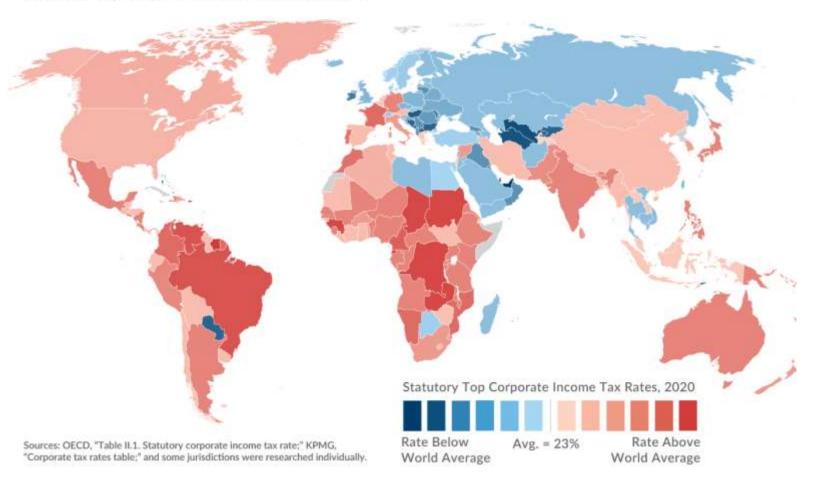
- Any 'unused' capital loss may be carried forward to be offset against capital gains in any future year(s).
- In most countries, individuals are given an allowance each year and only pay capital gains tax on chargeable gains in excess of this amount.
- For individuals, the amount chargeable to capital gains tax could be added on to the income liable to income tax and charged to CGT at the individual's marginal tax rate.
- In the UK, a rate of 10% or 20% (from April 2016) has applied to capital gains above the allowance, depending on the level of taxable income. Higher rates can apply to some gains, such as in the UK, for property which is not the individual's main home.

### What is Corporate Income Tax?

- A corporate tax is a tax on the profits of a corporation.
- The taxes are paid on a company's taxable income, which includes revenue minus cost of goods sold (COGS), general and administrative (G&A) expenses, selling and marketing, research and development, depreciation, and other operating costs.
- Corporate tax rates vary widely by country, with some countries considered to be tax havens due to their low rates.
- Corporate taxes can be lowered by various deductions, government subsidies, and tax loopholes, and so the effective corporate tax rate, the rate a corporation actually pays, is usually lower than the statutory rate; the stated rate before any deductions.

#### Corporate Tax Rates around the World

Statutory Top Corporate Income Tax Rates, 2020





Starting point for a company's tax assessment is 'profit on ordinary activities before taxation'

### **Accounting Profit**

Sales

- (-) Business Expenses
- (+) Non-Operating Income
- (-) Interest and other Finance Charges paid

#### **Profit Before Tax**

### **Taxable Profit**

Adjusting Accounting Profit with:

- a) Expenses disallowed under Tax Laws
- b) Add A/c Dep and Reduce Tax Dep
- c) Special Deductions / Tax Holidays
- d) Special Allowances



### **Uses of Corporate Income Tax:**

- **Dividends are paid from Profit after Tax** to ensure that dividends are not subject to both personal and corporate income tax
- How to encourage reinvestment of profit? Higher taxes on Dividends or allowing tax relief for reinvestment
- Accelerated Depreciation on New Capital Equipment

### 6 International Taxes

- International taxation is the study or determination of tax on a person or business subject to the tax laws of different countries or the international aspects of an individual country's tax laws as the case may be.
- If a country has a large diaspora, like India does, this becomes even more crucial.
- No citizen would want to be taxed twice, one from the country he earns and the one he is a citizen of.
- Therefore the concept of Double Taxation is introduced.

### 7 Double Taxation Relief

#### **Double Taxation Agreements between countries**

- Double taxation relief (DTR) means that the local tax authority will allow companies and individuals with overseas income or capital gains to offset tax paid overseas against their liability to domestic tax on that income or capital gains.
- Prevention of same income being taxed in both countries
- Local country to allow offset tax paid overseas against their domestic tax liability
- Effective Tax Rate shall be the higher Tax rate in either of the country

### 7 Double Taxation Relief

#### **Indian DTAA**

- Presently, India has the DTAA (Double Tax Avoidance Agreement) with more than 88 countries.
- This states that if a NRI is a resident in any of those 88 countries and he/she is paying taxes on income earned then he will be eligible for a tax benefit in either of the following two ways:
  - **Exemption method:** under this method, any one country will tax the income of NRI. Means if the income is taxed in India then the same income will not be taxed in his own country.
  - **Credit method:** under this method, both the countries will tax the income of that person but the country where he is a resident will allow him deduction or give credit to the foreign tax.

#### **Objectives of DTAA**

- Tax Credit / Relief
- Avoid Double Taxation
- Prevent Tax Discrimination
- Certainty of Tax Treatment to Investors
- Exchange of Information
- Ease in Recovery of Tax Dues
- Promote Investment & Mutual Relation
- Prevent Fiscal Evasion

## **Summary**

- Taxes are paid by individuals and companies to governments for the services and infrastructure provided and as a means to sustain welfare programs of countries which align with their overall development goals.
- Taxes should always be collected in a calibrated manner, without placing too much burden on tax payers while still being sufficient for the government's needs.
- Taxes can either be collected directly (like income tax, capital gains tax, etc) or indirectly (like GST, customs duty, etc)
- Personal Taxes are paid by individuals on incomes they earn. Personal tax rates have slabs which increase with increase in level of income. This is known as progressive taxation and helps in spreading the burden of taxes evenly on those able to bear it.
- Capital Gains Tax are paid on any profits or capital gains, individuals make.
- Corporation Tax is paid by companies/corporates on the profit they earn. Corporate Taxes make for a large part of the funding of governments.
- For people and organizations based in one country but working in another, there's a risk of being taxed twice.
- To avoid this issue, most major nations have double taxation avoidance agreements with each other.



# Thank You