

Class: MSc

Subject : Business Finance

Chapter: Unit 1 Chapter 3

Chapter Name: Indian and international tax system

Today's Agenda

1. What is tax?
 1. Types of tax
2. Personal taxation
2. Capital gains tax
2. Company tax
2. Other taxes
2. Double taxation relief

1 What is a 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.
- 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.)

1.1 Types of Taxes

Based on the means of collection, taxes can be classified into two types:

Direct tax

- Direct tax is a tax that is directly paid by the taxpayer on its earnings (salary, business profits, capital gains from sale of investments, lottery, etc.).
- Different types of Direct taxes are income tax, wealth tax, capital gains, property tax, gift tax, inheritance tax, and stamp duty

Indirect tax

- Indirect tax is a tax that is paid by individual at the time of making an expenditure. In other words, these taxes are imposed by the government on purchase of products and services.
- Different types of indirect taxes are GST, VAT, excise, octroi, CST, customs duty, and service tax.

2 Personal taxation

Personal taxation is typically levied on all of the financial resources of an individual such as:

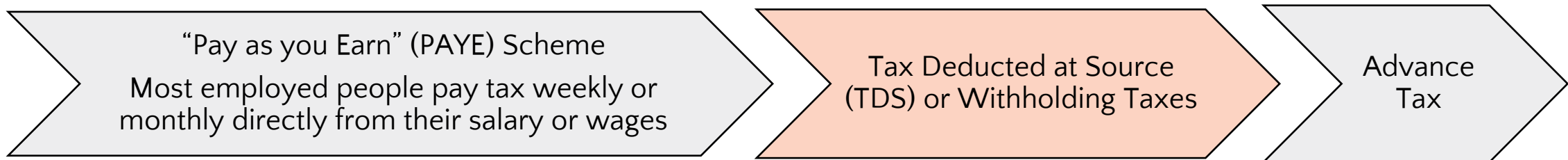
- income (whether earned – wages and salaries – or unearned – investment income and rent)
- profit from operating as a sole trader or partner
- inherited wealth
- investment gains
- value of assets held



2 Personal taxation

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.



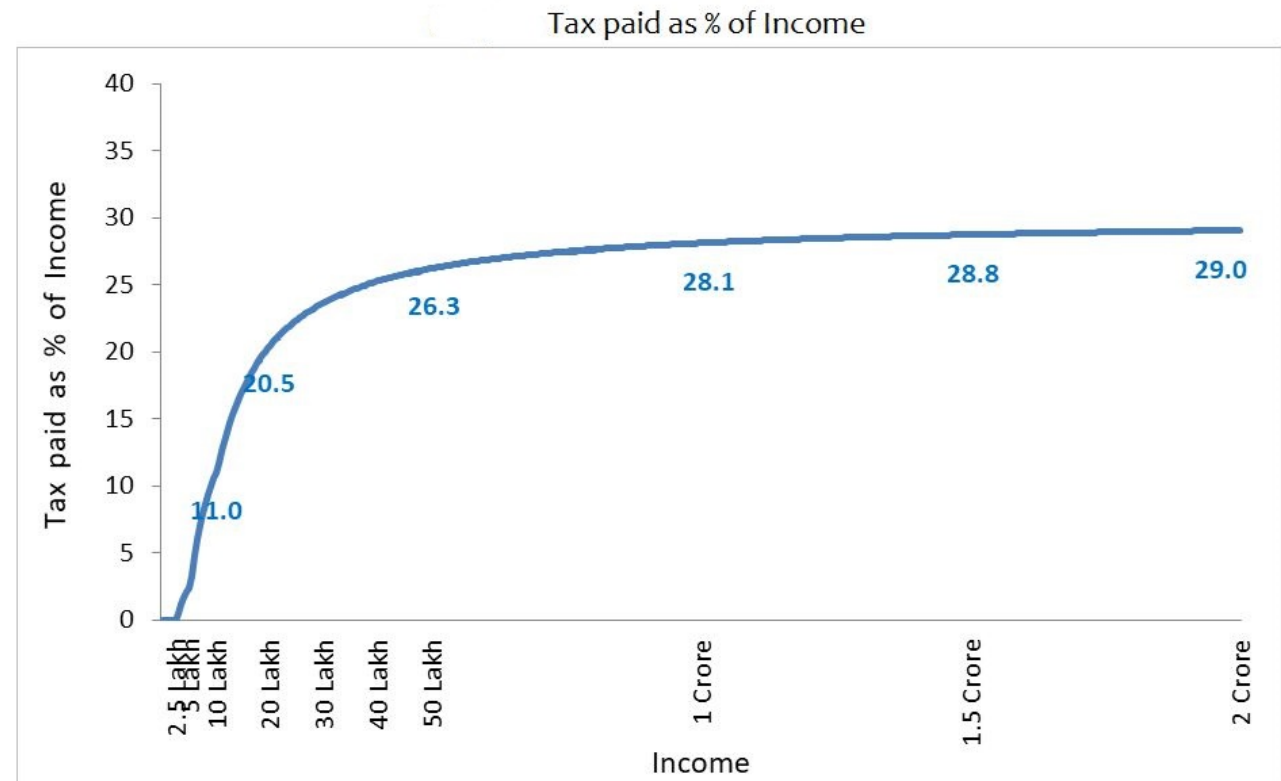
2 Personal taxation

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



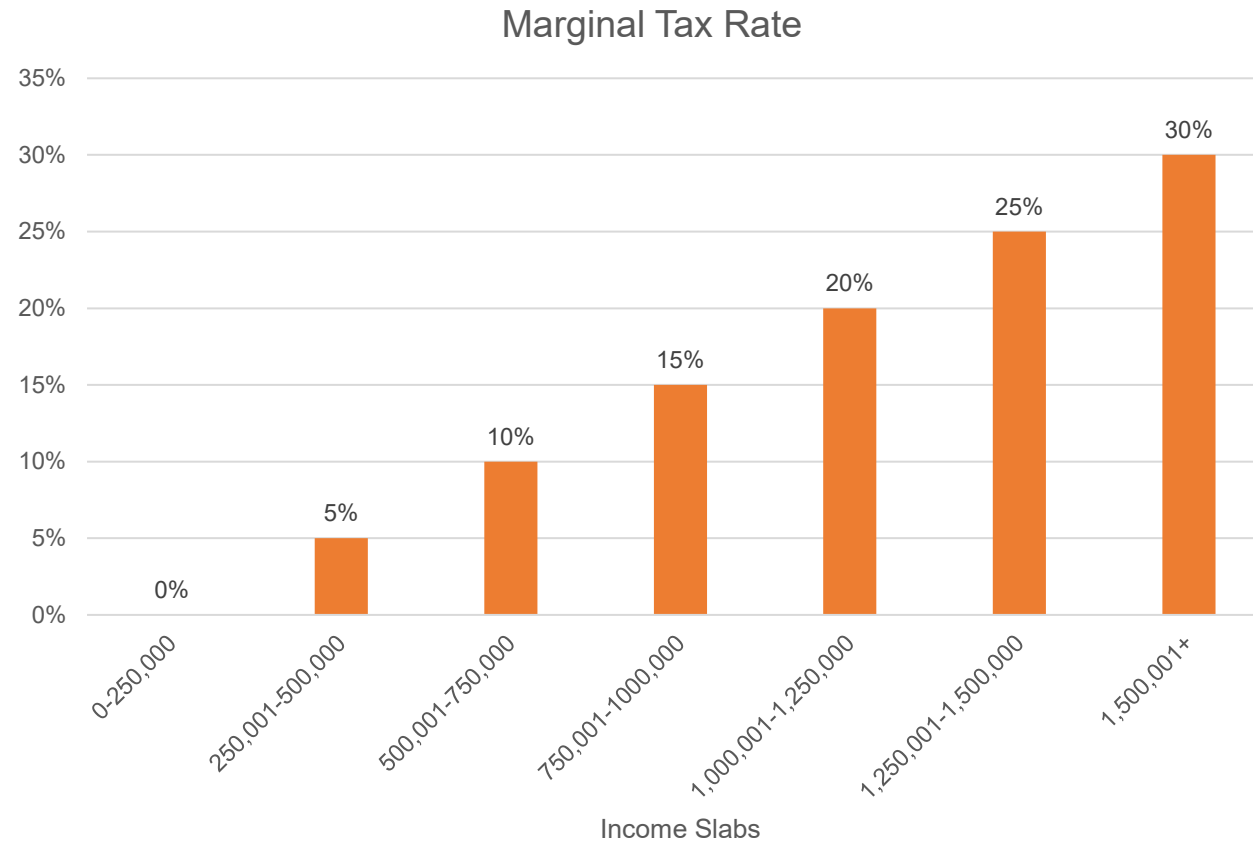
2 Personal taxation

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

2 Personal taxation

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



2 Personal taxation

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)

3 Capital Gains Tax

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



3 Capital Gains Tax

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

3 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 reinvestment 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

3 Capital Gains Tax



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.

4 Company Tax

What is Corporate Income Tax?

- A corporate tax is a tax on the profits of a corporation.
- 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.

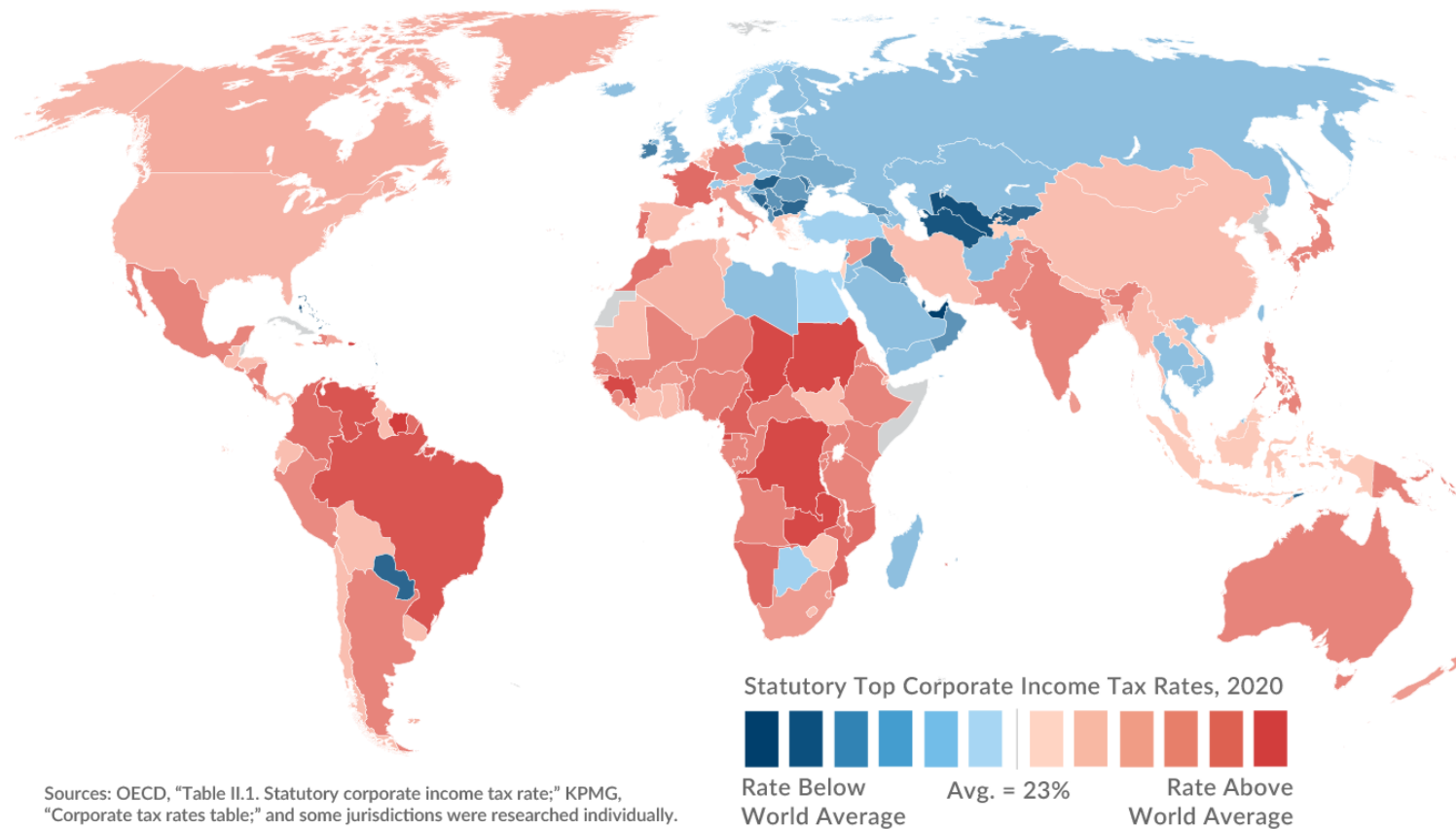


Accounting profit or Profit before tax = Sales revenue – expenses + non trading income (dividends, interest, or capital gains) – interest paid

4 Company Tax

Corporate Tax Rates around the World

Statutory Top Corporate Income Tax Rates, 2020



Sources: OECD, "Table II.1. Statutory corporate income tax rate;" KPMG, "Corporate tax rates table;" and some jurisdictions were researched individually.

4 Company Tax

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

4 Company Tax

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

5 Other taxes

1. Stamp duty

Stamp duty is defined as the legal tax which needs to be paid by the buyer as proof that payment for the purchase of property is completed. As physically transferring any property is not regarded as a legal transaction, stamp duty needs to be paid as purchase proof.

2. Inheritance tax

Inheritance tax is tax levied on the income that an individual earns by inheriting any asset like ancestral property, jewelery, or automobile. As the property is equally divided among the siblings, thus, the tax will be borne by all inheritors. The tax is also known as estate duty or estate tax. This tax is not currently applicable in India and mostly comes under direct tax.

3. Property tax

Property tax further is the type of tax levied on real estate by municipal authorities like municipalities, municipal corporations, or panchayat. This tax is computed on the property value.

5 Other taxes

4. Sales tax

It is the percentage of tax paid on the value of the item which is sold.

5. VAT

Value-added tax (VAT) is defined as the type of indirect tax which is levied on each production process stage on the amount of value added to the product at that particular production stage. The amount of tax is collected from the stage of the manufacturer to the retailer.

6. Custom duties

Customs duties are the tax that is paid on imported goods.

7. Excise duty

Excise duty lastly is the tax that is levied on goods sold or produced within the country like duties on beer, petrol, or cigarettes.

6 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

6 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