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**TEERTHANKAR MAHAVEER COLLEGE OF LAW AND  
LEGAL STUDIES**

**LAW OF TAXATION STUDY MATERIAL  
(LAW 806)**

**UNIT I**

**(CONCEPT OF TAX)**

**BY**

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# CONCEPT, NATURE AND CHARACTERISTICS OF TAXATION AND TAXES

## **1. Meaning of Taxation**

**Taxation** is the inherent power of the state, acting through the legislature, to impose and collect revenues to support the government and its recognized objects. Simply stated, taxation is the power of the State to collect revenues for public purpose.

## **2. Purpose of Taxation**

**Primary Purpose** - is to provide funds or property with which the government discharges its appropriate functions for the protection and general welfare of its citizens.

### **Non Revenue Objectives**

Aside from purely financing government operational expenditures, taxation is also utilized as a tool to carry out the national objective of social and economic development.

1. to strengthen anemic enterprises by granting them tax exemptions or other conditions or incentives for growth;
2. to protect local industries against foreign competition by increasing local import taxes;
3. as a bargaining tool in trade negotiations with other countries;
4. to counter the effects of inflation or depression;
5. to reduce inequalities in the distribution of wealth;
6. to promote science and invention, finance educational activities or maintain and improve the efficiency of local police forces;
7. to implement police power and promote general welfare.

## **3. Meaning of Taxes**

**Taxes** are enforced proportional contributions from persons and property levied by the law making body of the state by virtue of its sovereignty for the support of the government and all public needs.

Tax in a general sense, is any contribution imposed by the government upon individuals for the use and service of the state, whether under the name of toll, tribute, impost, duty, custom, excise, subsidy, aid, supply or other name. Tax, in its essential characteristics, is not a debt.

## **4. Essential characteristics of tax**

1. it is an enforced contribution
2. it is generally payable in money.
3. It is proportionate in character, usually based on the ability to pay
4. it is levied on persons and property within the jurisdiction of the state
5. it is levied pursuant to legislative authority, the power to tax can only be exercised by the law making body or congress
6. it is levied for public purpose
7. it is commonly required to be paid a regular intervals.

## **5. CANONS OF TAXATION**

The qualities or attributes of a good tax are called canons of taxation. It was none other than Adam Smith who gave first a detailed and comprehensive statement of the principles of taxation. According to Findlay Shirras, “No genius, however, has succeeded in condensing the principles into such clear and simple canons as has Adam Smith.”

Adam Smith has given the following four canons of taxation.

- 1) Canon of Equality 2) Canon of Economy 3) Canon of Certainty and 4) Canon of Convenience.

### ***A. CANON OF EQUALITY***

Canon of equity or equality is the most important and basic Canon of taxation. It is based on the principle of social justice and ability to pay. Tax burden should be equally distributed among the tax payers according to their ability to pay. That is, the rich people should bear a heavy burden and the poor a less burden. Hence, the tax system should be progressive. According to Adam Smith, “The subject of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities, that is, in proportion to the revenue which they respectively enjoy under the protection of the state.”

### ***B. CANON OF ECONOMY***

Canon of economy explains that taxes should be collected at minimum cost. The tax laws and procedures should be simple. The administrative machinery should not be elaborate and costly. According to Adam Smith, “Every tax ought to be so contrived as little to take out and to keep out of the pockets of the people as possible over and above what it brings in to public treasury of the state.” Adam Smith argued that lack of economy would result when:

- 1) Tax administration is costly on account of complicated taxes.
- 2) Taxes are unduly heavy which would discourage investment, so that the income level reduces, hence the relative tax yields.
- 3) Taxes are having elaborate and complicated administrative supervision and
- 4) Taxes are unproductive in yielding sufficient revenue.

### ***C. CANON OF CERTAINTY***

Taxation must have an element of certainty. That is, there must be certainty about the tax which an individual has to pay. Things like the time of payment, the manner of payment, and the quantity to be paid etc. should be plain and clear to the tax payer. It should not be arbitrary. According to Adam Smith, “The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid ought to be clear and plain to the contributor and to every other person.”

### ***D. CANON OF CONVENIENCE***

It explains that a tax should be levied in such manner or in such a time that it is convenient for the tax payer to pay it. In the words of Adam Smith, “Every tax ought to be levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it.”

## **6. OTHER CANONS OF TAXATION**

Besides the four canons put forward by Adam Smith, there are some other canons given by writers like Charles F. Bastable. They are canon of productivity, canon of elasticity or flexibility, canon of simplicity, canon of diversity, canon of coordination etc.

- A. CANON OF PRODUCTIVITY:-** Tax should be productive of large revenue. According to this canon it is desirable to have a few taxes yielding large revenue rather than having a large number of taxes yielding small revenue. It also implies that instead of imposing large number of unproductive taxes, it is advisable to have a few productive taxes.
- B. CANON OF ELASTICITY:-** It means that taxation should be flexible or elastic. That is, it should be capable of increasing or decreasing the tax revenue depending on the need of the government. In other words, the tax revenue may increase automatically whenever needed by an upward revision of tax rates or by extension of its coverage.
- C. CANON OF DIVERSITY:-** This implies that there should be a number of different taxes in the country. This will make every citizen of a country to pay something to the national exchequer. As the number of taxes increases it will increase the administrative costs, reducing the revenue. Hence, too many taxes are to be avoided.
- D. CANON OF SIMPLICITY:-** This canon implies that the tax should be simple to understand even to a layman. It should be free from all ambiguities and provisions to avoid differences in interpretation and legal disputes.
- E. CANON OF CO-ORDINATION:-** There should be co-ordination among different layers of governments in imposing taxes. Especially, in a federal country like India there should be coordination among the central, state and local governments regarding taxes, since each of these is having legal right to impose taxes.

## **FAQs on Concept, Nature and Characteristics of Taxation and Taxes**

### **1. What is taxation?**

Ans. Taxation refers to the process of collecting a mandatory fee or a charge from individuals, organizations, or businesses by the government to fund public goods and services. Governments use taxation to finance public services such as education, healthcare, infrastructure, defense, and other social welfare programs.

### **2. What are the different types of taxes?**

Ans. There are various types of taxes levied by the government, which include income tax, corporate tax, sales tax, property tax, excise tax, customs duty, and value-added tax (VAT). These taxes are collected by the government to fund public services and to regulate the economy.

### **3. What are the characteristics of taxation?**

Ans. The characteristics of taxation are as follows: (i) It is an obligatory payment imposed by the government on individuals, businesses, and organizations; (ii) It is a non-voluntary payment, i.e., people have to pay it whether they like it or not; (iii) It is a proportional payment, i.e., people have to pay taxes based on their income or property; (iv) It is a continuous payment, i.e., people have to pay taxes regularly; (v) It is a universal payment, i.e., everyone who meets the criteria has to pay taxes.

### **4. What is the purpose of taxation?**

Ans. The main purpose of taxation is to raise revenue for the government to fund public goods and services. It is an effective way for the government to redistribute wealth and reduce income inequality. Taxation also helps the government to regulate the economy by encouraging or discouraging certain activities and behaviors.

### **5. How does taxation affect the economy?**

Ans. Taxation has a significant impact on the economy. High tax rates can discourage investment, saving, and consumption, while low tax rates can encourage economic growth and development. Taxation can also affect income distribution, as it can be used to redistribute income from the rich to the poor. Additionally, taxation can be used to regulate certain industries and to address externalities such as pollution.

## **7. TYPES OF TAXES :**

### **What is Direct Tax?**

Direct tax is levied on people's income or profits. For example, a taxpayer pays the government for different purposes, including income tax, personal property tax, FBT, etc. The burden has to be borne by the person on whom the tax is levied and cannot be passed on to someone else. Central Board of Direct Taxes (CBDT) governs and administers the Direct Tax.

### **What are the Direct Taxes Imposed in India?**

Some of the important direct taxes imposed in India are mentioned below:

- **Income Tax-** It is imposed on an individual who falls under the different tax brackets based on their earnings or revenue, and they have to file an income tax return every year, after which they will either need to pay the tax or be eligible for a tax refund.
- **Corporate tax-** Companies incorporated or having operations in India have to pay tax to the government. They need to pay tax on the profits earned from the business. Unlike, income tax slab rates of individuals, the companies have to pay tax at flat rates prescribed by the government.
- **Securities Transaction Tax (STT)-** STT is a tax levied while dealing with securities listed on a recognised stock exchange. It is an amount that is levied over and above the trade value, and hence, it increases the transaction value.
- Estate and Wealth taxes are now abolished.

### **What are the Advantages of Direct Taxes?**

Direct taxes do have a certain advantage for a country's social and economic growth. To name a few,

- **It curbs inflation:** The Government often increases the tax rate when there is monetary inflation, which in turn reduces the demand for goods and services. As a result of descending demand, inflation is bound to condense.
- **Social and economic balance:** Based on every individual's earnings and overall economic situation, the Government has well-defined tax slabs and exemptions in place so that the income inequalities can be balanced out.

### **What is the Most Common Disadvantage of Direct Taxes?**

Direct taxes have a handful of disadvantages. However, filing tax returns is a taxing task itself, as it is very time-consuming.

### **What is Indirect Tax?**

Conversely, indirect tax is levied by the government on goods and services. Therefore, it can be shifted from one tax-paying individual to another. E.g; the wholesaler can pass it on to retailers,

who then pass it on to customers. Therefore, customers bear the brunt of indirect taxes. The Central Board of Indirect Taxes and Customs (CBIC) governs and administers indirect taxes.

Earlier, an indirect tax meant paying more than the actual price of a product bought or a service acquired. And there was a myriad of indirect taxes imposed on taxpayers.

**Goods and Service Tax (GST)** is one of the existing indirect tax levied in India. It has subsumed many indirect tax laws. Let's discuss a few indirect taxes that were earlier imposed in India:

- **Customs Duty**- It is an Import duty levied on goods coming from outside the country, ultimately paid for by consumers and retailers in India.
- **Central Excise Duty** - This tax was payable by the manufacturers who would then shift the tax burden to retailers and wholesalers.
- **Service Tax** - It was imposed on the gross or aggregate amount charged by the service provider on the recipient.
- **Sales Tax**– This tax was paid by the retailer, who would then shift the tax burden to customers by charging sales tax on goods and services.
- **Value Added Tax (VAT)** – It was collected on the value of goods or services that were added at each stage of their manufacture or distribution and then finally passed on to the customer.

## **8. GST AS INDIRECT TAX**

With the implementation of GST, we have already witnessed a number of positive changes in the fiscal domain of India. The various taxes that were mandatory earlier are now obsolete, thanks to this new reformed indirect tax. Not just that, GST is making sure the slogan “One Nation, One Tax, One Market” becomes the reality of our country and not just a dream.

That said, with the dawning of the ‘Goods & Services Tax (GST), the biggest relief so far is clearly the elimination of the ‘cascading effect of tax’ or the ‘tax on tax’ quandary.

Cascading effect of tax is a situation wherein the end-consumer of any goods or service has to bear the burden of the tax to be paid on the previously calculated tax and as a result would suffer an increased or inflated price.

Under the GST regime, however, the customer is exempted from the tax they would otherwise pay as a result of the cascading effect.

## **Types of Supply and Taxes Levied Thereon**

**Intra state Supply:** Supply of goods and services within the state. In such cases GST is levied at equal rates by Central govt and by State govt. Types of taxes levied are

- **Central Goods and Services Tax (CGST) :** It is levied and collected by Central Government on intra-State supplies of taxable goods and services.
- **State Goods and Services Tax (SGST) or Union Territory Goods and Services Tax (UTGST) :** It is levied and collected by State Government or Union Territories without Legislatures on intra-State supplies of taxable goods and services.

**Interstate Supply:** Supply of goods and services between different states and union territories. Type of tax levied is

- **Integrated Goods and Services Tax (IGST) :** IGST is the sum total of CGST and SGST/UTGST and is levied by the Centre on all inter-State supplies.

## **What are the Advantages of Goods and Service Tax (GST)?**

**There are several benefits of GST. Let's list a few:**

- **Input Tax Credit:** At the time of paying tax on the final product, one can reduce the tax they have already paid on their purchases and pay just the balance amount. This is called Input Tax Credit which again reduces the burden of a hefty tax.
- **Composition Scheme under GST:** The government has done a commendable job by introducing Composition Scheme for small businesses with a turnover below Rs.1.5 crore. In case of North-Eastern states and Himachal Pradesh, the limit is now Rs.75 lakh. As per the scheme, they don't have to go through the time-consuming formalities of GST but only pay the tax at a fixed rate based on their business turnover. Isn't that a relief for small taxpayers? It sure is!
- **Zero-rated exports:** GST on the export of any kind of goods or services will not be charged. It will be considered as a zero-rated supply.
- **Compliance:** Various digital products, including new returns, e-wallets, and e-invoicing are created to facilitate easier and more efficient tax management.

## **9. TAX EVASION AND TAX AVOIDANCE**

In India, many people try various methods to avoid paying taxes. Tax evasion and tax avoidance are often used interchangeably to describe these actions. However, they are distinct terms with the same goal which is to reduce taxes or avoid paying them. This blog explains to you the difference between tax evasion and tax avoidance.

### ➤ **What is Tax Evasion?**

Tax evasion means illegally trying to pay less tax by using fraudulent methods. Tax evasion includes lying about your finances, hiding income statements, not keeping good records of transactions, saying you have more tax breaks than you really do or showing personal expenses as a part of business expenses.

It is a crime and can lead to punishment under the law.

#### Common Tax Evasion Tricks

Tax evasion takes place when you trick tax authorities on purpose. Here are the different tricks they use:

- **Hiding Income:** Not telling about all the money you make, like cash from a side job or interest from investments that you do not report.
- **Overstating Deductions:** Saying you spent money on things for your job that you did not really spend, or claiming tax breaks for personal stuff you do not qualify for.
- **Submitting Fake Tax Forms:** Sending in a tax form with wrong information on purpose.

#### **Examples of Tax Evasion**

Here are some examples of tax evasion:

- You earn a good amount of money from freelance gigs or a small business you run on the side, but you do not mention any of this income on your tax papers.
- A business owner claims fancy dinners, lots of travel, or personal shopping sprees as business expenses to make it seem like they earned less and pay less tax.
- You hide your money in a secret bank account overseas to avoid paying taxes on it.
- Getting involved in the underground market, like smuggling stuff to skip import taxes or getting paid in cash to avoid reporting your income.

### ➤ **What is Tax Avoidance?**

Tax avoidance involves using legal tactics to reduce the amount of tax you owe. Essentially, it means using the tax system in one place to benefit yourself by paying less tax. Tax avoidance is about finding new ways to avoid paying taxes, all the while staying within the limits of the law.

It can involve adjusting financial records so you do not break any tax rules. While tax avoidance is allowed, sometimes it can be seen as a crime, especially in certain situations.

#### Common Tax Avoidance Tricks

Here are some common tax avoidance tricks to avoid paying as much tax as possible. Here are some of them:

- Maximising Deductions: Claiming all the deductions allowed by law, like medical expenses, donations, and certain investment costs.
- Using Special Accounts: Putting money into retirement funds like the [PPF](#) or [NPS](#), which lets you pay less tax.
- Taking Advantage of Tax Credits: Getting credits, like for education expenses, that directly lower your tax bill.

### **Examples of Tax Avoidance**

Here are some examples of tax avoidance:

- Utilising *Section 80C* benefits by investing in financial instruments like PPF or ELSS mutual funds to help you lower the amount of tax you need to pay.
- You can show the money you spent as interest on your home loan, buying health insurance, or paying school fees to lower your tax bill.
- Giving money to approved charities or organisations can give you tax breaks. Sometimes, even giving to political causes can help you save on taxes.

Now that you have a fair understanding of the basics, let's differentiate between tax evasion and tax avoidance in detail.

### **Difference Between Tax Evasion and Tax Avoidance**

The following table gives a comparison of tax evasion vs tax avoidance:

Parameters	Tax Evasion	Tax Avoidance
Goal	To illegally evade or avoid paying taxes.	To reduce your tax liability while staying within the boundaries of the law.
Legality	Illegal	Legal

Occurrence	After you incur a tax liability.	Before you incur a tax liability.
Methods Used	Utilises fraudulent activities and false information	Utilises legal deduction methods and tax provision strategies
Results	You may face penalties, fines, legal actions, and damage to your reputation.	You would not face any legal consequences.