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TAXATION SYSTEM IN INDIA

International Framework Compliant system -

India has signed **Double Taxation Avoidance Agreement** with more than **70 countries** with a view to give benefits to the Indian individuals and companies operating in / with treating countries and also to encourage Foreign Equity and Trade participation from such countries.

So far as the **Indirect Taxation** is concerned, on **Customs Duty**, India has adopted **Harmonised Classification (HSN)** and **GATT** based valuation system. Further, India also has WTO complaint **Anti-dumping Duty / Safeguard Duty** policy.

Taxability Criteria for Direct Tax

The liability to Income Tax in India is attracted on the basis of residential status of a taxpayer in the relevant financial year, in which the income accrues or arises to him or is received by him. Conditions for the determination of residential status are prescribed in Section 6 of the Income Tax Act, 1961.

The **Indian Income Tax Act, 1961** provides for levy of Income Tax on the income of foreign companies and non-residents to the extent it is sourced from India.

Income Tax Rates

The amount of payable Income tax in India depends upon the relevant slab within which the net income of the Assessee falls during the relevant period. Minimum tax rate in case of Individual, Hindu Undivided Family (HUF), Association of Persons (AOP), Artificial Juridical Person etc. is 10% and maximum is 30%.

For Domestic Companies having net income not exceeding Rs. 1 Crore, the rate of tax is 30% which in case of Foreign Company, is 40%. Further, for income above Rs. 1 Crore, surcharge at the rate of 10% is charged from Domestic Company and 2.5% from the Foreign Company.

Indirect taxation system in India

India's Indirect Taxation system includes various taxes such as Excise Duty, Custom Duties, Service Tax, Value Added Tax (VAT), etc. Business activities, be it manufacturing, trading, exports or service; all falls within the ambit of indirect taxes.



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Customs Duty

In India, the Customs Duties generally consist of the following:

1. **Basic Duty:** levied at a standard rate or in case of import from the designated / specified country(ies) at a preferential rate.
2. **Additional Customs Duty / Countervailing Duty (CVD)** - it is levied at a rate equivalent to Central Excise Duty imposed on the indigenously manufactured goods. The MRP based valuation prevailing under central excise is extended to Customs also and it is calculated on a value base of aggregate of value of the goods including landing charges and basic customs duty.
3. **Additional Duty of Customs:** not exceeding 4% - levied under Section 3(5) of the Customs Tariff Act, 1975
4. **National Calamity Contingent Duty (NCCD):** Imposed @ 1% on mobile phones, two-wheelers, motor cars and multi-utility vehicles and Rs.50 per m.t. on imported crude oil.
5. **Anti-dumping Duty / Safeguard Duty:** For protecting domestic industry from unfair injury – imposed on specified goods.
6. **Education Cess / Secondary & Higher Education Cess:** Education Cess @ 2% and Secondary & Higher Education Cess @ 1% of aggregate duty of customs (including CVD) is leviable.

The Central Government has the power under Section 25 of the Act of 1962 to exempt (including to modify or withdraw the exemption) in public interest, specified goods from levy of customs duty by issuing a notification or by special orders.

Excise Duty –

Excise duty is imposed on all excisable goods manufactured or produced in India. But all goods manufactured / produced in India are not excisable. Only those goods specified in the Schedule to the Central Excise Tariff Act, 1985 (CETA) have been referred to as the excisable goods. The charging section i.e. Sec.3 of the Central Excise Act, 1944 provides following four basic conditions for levy of Central Excise -

- The duty is on goods.
- There must be excisable goods.
- The goods must be 'manufactured or produced'
- Such manufacture or production must be in India.



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Until and unless *all* of these conditions are satisfied, Central Excise Duty can not be levied.

Service Tax:

At present, over 100 services mentioned in **clause (105) of section 65 of finance Act, 1994** are liable to service tax. Further section 93(1) of the Finance Act, 1994 empowers the central government to grant exemptions from payment of Service tax. In exercise of these powers the central government has granted partial/full exemptions to several services. Though there is a uniform rate of tax for all services, classification is important to actually determine the taxability.

Rate of Service Tax:

The tax is levied at a uniform rate of 10% on the value of taxable service with 2% Education Cess and 1% Secondary & Higher Education Cess on the amount of tax payable, making the total Service Tax payable to be 10.36%.

Liability to pay Service Tax:

Any person providing the taxable service is required to charge Service Tax from his client and pay it to the Government. However, in some of the cases, the receiver of Service has been made responsible for paying the Service tax to the Government.

Value Added Tax (VAT):

Unlike the previous single-point sales tax system, VAT is a multi-point destination based system of taxation, with tax being levied on value addition at each stage of transaction in the production/ distribution chain. The term 'value addition' implies the increase in value of goods and services at each stage of production or transfer of goods and services. Only the value addition in the hands of each of the entities is subject to tax with the facility of set-off of input tax credit. The input tax credit in relation to any period means setting off the amount of input tax by a manufacturers / registered dealer against the amount of his output tax.

VAT regime:

In India states have the power to levy tax on sales under entry 54 in list II of the Seventh Schedule of the constitution of India. Thus the levy of vat is different from other countries following similar system of taxation. The federal nature made it necessary for the "empowered committee" to work in collaboration with various states and chart out a basic framework for uniform VAT laws. The new VAT regime came into effect from 1 April 2005. Of the 28 Indian states, eight did not introduce VAT. Haryana had already adopted it on 1 April 2004.



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Rates:

The tax rate scheme of VAT is state specific. The states have on general agreed to levy VAT of 12.5 % with certain commodities attracting higher (20%) or lower (1% or 4%) rates. Generally commodities of nature of basic necessities attract lower (merit) rates and luxury items and items like alcohol attract higher (demerit) rates. There also exists a list of exempted goods as notified by the specific State.

CST and VAT:

As per the Constitution of India inter-State trade can only be taxed by the Union and not by any State. The introduction of VAT taxation scheme has not altered this and Central Sales Tax (CST) still exists. Thus any sale that occurs in course of inter-state trade or in course of import or export of goods out of the territory of India does not come within the purview of VAT. Hence Input tax credit will not be available on Inter State purchases, one state Govt. cannot be expected to give credit for the tax paid in another state. There is a proposal for progressively reducing CST rate for sale to registered dealers to zero.