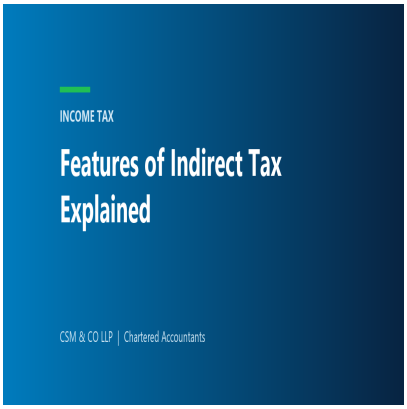

Features of Indirect Tax Explained

Description

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Quick summary

- Indirect taxes are charged on goods and services and the burden is passed on to the final consumer.
- Today the main indirect taxes are GST, customs duty, a limited central excise and state VAT on petroleum and alcohol.
- Key features: shifting of burden, tax on consumption, broad base, easy collection, possible inflationary effect and regressive nature.
- GST removed the cascading effect of the old regime through input tax credit.

Indirect taxes are taxes on spending rather than on earning. They are built into the price of goods and services, collected by businesses and paid to the government, while the final burden falls on the consumer. Direct taxes, such as income tax, are charged on income. This note explains what indirect tax is, which taxes fall under it in India today, and its main features.

What is Indirect Tax?

An indirect tax is charged on the supply of goods and services and not on the profit of the person who pays it to the government. It is collected by intermediaries in the supply chain, such as manufacturers, wholesalers and retailers, and the consumer who finally uses the product bears the burden.

Which indirect taxes exist in India today?

- **Goods and Services Tax (GST):** the main indirect tax on the supply of goods and services. It has replaced most earlier indirect taxes since 1 July 2017.
- **Customs duty:** charged on goods imported into India (and on a few exports).
- **Central excise duty:** now limited to a small set of goods, mainly petroleum products, as most goods moved into GST.
- **State VAT:** still charged by states on petrol, diesel and some other petroleum products, and on alcohol for human consumption, which are outside GST.

Service tax, the earlier central VAT, state VAT on most goods, central sales tax and octroi have been subsumed in GST.

Key features of indirect taxes

1. The burden can be shifted

The person who pays the tax to the government can recover it from the next person in the chain, until it reaches the final consumer.

2. A tax on consumption

The tax depends on what is bought and not on the buyer’s income, so it affects the price of goods and services.

3. A broad tax base

Because almost everyone buys goods and services, indirect taxes reach a very wide base and give the government a steady flow of revenue.

4. Possible inflationary effect

A higher tax rate raises the selling price, which can add to inflation.

5. Easy to collect

The tax is collected in small amounts at the point of sale by registered businesses, so the government collects it from far fewer people than the number who finally bear it.

6. Cascading effect, removed in GST

Under the old regime, tax was often charged on a price that already contained tax, and the effect repeated at every stage. GST avoids this through input tax credit, so tax paid on purchases can be set off against tax on sales.

7. Regressive nature

Everyone pays the same rate on the same item, so the tax takes a larger share of the income of low-income households than of high-income ones. GST softens this with lower rates on essentials.

Impact of indirect taxes

Indirect taxes change prices and spending patterns, and so affect the cost of living and the purchasing power of consumers. For businesses, they influence pricing, competition and cash flow, especially through the timing of input tax credit. For the government, they are a major source of revenue that funds public services and infrastructure.

Conclusion

Indirect taxes are paid by everyone who buys goods and services. Knowing how they are charged helps consumers read the tax on their bills and helps businesses price correctly and claim the credit they are entitled to.

Frequently asked questions

What is an indirect tax?

An indirect tax is a tax on the supply of goods and services. It is collected by sellers and paid to the government, while the final burden falls on the consumer.

Which are the main indirect taxes in India now?

GST, customs duty, a limited central excise duty mainly on petroleum products, and state VAT on petrol, diesel and alcohol for human consumption.

Why is indirect tax called regressive?

Everyone pays the same rate on the same item, so the tax takes a larger share of income from low-income households than from high-income households.

What is the cascading effect of tax?

It is tax charged on a price that already includes tax, repeated at every stage of the supply chain. GST avoids it through input tax credit.

Official sources

- CBIC: Central Board of Indirect Taxes and Customs
- GST Portal: Goods and Services Tax

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