

B.A. Part IInd (Economics Honours)  
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## **Direct and Indirect Tax**

According to Prof. Dalton “That a direct tax is really paid by a person on whom it is legally imposed, while an indirect tax is imposed on one person, but paid partly or wholly by another, owing to consequential change in the term of some contract or bargaining between them.”

Thus, an indirect tax is conceived as one which can be shifted or passed on; a direct tax is one which cannot be shifted to others.

In the case of direct tax impact or the money burden and the incidence of tax are on the one and the same person; while in the case of indirect taxes, the impact and incident of taxes are on different persons.

An income tax is generally regarded as a direct tax while custom and excise duties are indirect taxes.

**Direct taxes** – income tax, corporation tax, wealth tax, estate duty and gift tax etc.

**Indirect taxes** – customs, excise, sales tax entertainment, and tax goods and service tax etc.

### **Merits of direct taxes**

1. Economy – Direct taxes are economical in the sense of cost of collecting these taxes for the government is relatively low.
2. Equity – Direct taxes chosen and determined according to the ability to pay and the minimum aggregate sacrifice i.e. it is based on just and equity. These taxes fall more heavily on the richer persons than on the poor.
3. Reduction in inequalities – As direct taxes are progressive in nature, the person belonging to higher income groups are imposed higher rate of taxation. On the other hand, low income groups ever exempted of some taxes. In this way, it responsible for removing the disparity among society to a great extent.

4. Civic Consciousness.
5. Certainty – Direct taxes also satisfy the canon of certainty because of its certain effects on the tax payer. So one can make adequate provision for payment of taxation in advance.
6. Elasticity – it is elastic in nature because the income from these taxes can be increased by increasing the rate of taxation in an appropriate way in the hour of crises.
7. Easy to understand.

### **Demerits of direct taxes**

1. Inconvenience – Direct tax is inconvenient because it requires numerous accounting and other formalities to be observed. Sometime tax payer has to pay a large amount of taxation in lump sum which causes inconvenience to the tax payers.
2. Uneconomical – the cost of collection of such taxes is quite high particularly when the number of tax – payers are infinite and the amount of tax collected is in small quantity.
3. Possibility of evasion – A direct tax is calculated on the basis of honesty of tax payers. So there is always a possibility of tax evasion. People do not show their correct income to the tax officials. They adopt fraudulent practices to save themselves from the tax.
4. Uncertainty.
5. Only political decision.
6. Narrow in scope

### **Merits of indirect taxes –**

1. Convenience – indirect taxes are convenient because they are, generally, included in the price of commodity and the burden is not felt by the consumer. People pay taxes without any obligations because of their necessities. It is quite convenient as they are imposed on the manufacturer or importer.
2. Elastic – indirect taxes are highly elastic in nature as the revenue from these taxes can be increased as and when desired.
3. No possibility of evasion.

4. Equity.
5. Higher production and investment – government can shift the production and investment from lower priority industries to higher priority industries by imposing higher rate of taxation low priority products and giving relief to high priority products.
6. Social welfare – heavy indirect taxation on article like wine, opium etc serves a great social purpose by curtailing consumption of such harmful commodities.
7. Progressive in nature – luxurious commodities are heavily taxed and essential commodities are exempted from tax.
8. Wider coverage
9. Suitable to developing economies.

#### **Demerits of indirect taxes-**

1. Regressive in nature – these taxes are regressive in nature because they fall on all persons indiscriminately, irrespective of their ability to pay.
2. Uncertainty - anticipation of government revenue collection is very difficult because as the commodity is taxed, the market price rises which results in the fall in demand depending upon elasticity of the demand. So, it is quite difficult to anticipate the fall in demand with the imposition of taxes.
3. No civic consciousness.
4. Discourage saving.
5. Inflationary.
6. More uneconomical.
7. Inequitable.