

# TAX REFORMS IN INDIA

August 26, 2020

Recent Tax reforms are aimed at Ease of Living and Ease of Doing Business and at the same time are aimed at rewarding the honest taxpayers of India. UPSC may focus on a broad framework of recent reform measures, key aspects such as what is faceless assessment, taxpayer charter etc.

## Static dimensions

1. What is tax reform?
2. Tax reforms announced in the budget

## Current dimensions

1. Atmanirbhar Package
2. Recent Tax Reforms announced by the PM
3. Taxpayer's Charter

## What is Tax reform?

While India has had a history of periodically assessing the tax structure, through the constitution of tax reform committees (India 1971, 1977), actual reform attempts were largely ad hoc; it required a crisis of some severity before systematic tax reforms were implemented. Fiscal and balance of payments crises of 1991 warranted systematic reform not only to improve the revenue productivity of the tax system to phase out fiscal imbalance, but also to reorient the tax system to the requirements of a market economy. Tax reforms were an integral part of this larger reform initiative.

The Tax Reforms Committee (India 1991) laid out a framework and a roadmap for the reform of direct and indirect taxes as a part of the structural reform process. The paradigm shift in tax reforms adopted by the TRC was in keeping with the best practice approach of broadening the base, lowering marginal tax rates, reducing rate differentiation, simplifying the tax

structure, and adopting measures to make the administration and enforcement more effective. The important proposals put forward by the TRC included reduction in the rates of all major taxes, i.e., customs, individual, and corporate income and excise taxes to reasonable levels, maintain progressivity but not such as to induce evasion.

The TRC recommended a number of measures to broaden the base of all the taxes by minimizing exemptions and concessions, drastic simplification of laws and procedures, building a proper information system and computerization of tax returns, and revamping and modernization of administrative and enforcement machinery. It also recommended that the taxes on domestic production should be fully converted into a value added tax, and it should be extended to the wholesale level, in agreement with the States, with additional revenues beyond post-manufacturing stage passed on to the State governments.

The tax reforms witnessed thereafter sought to follow the directions spelt out in this report. While the TRC laid down the analytical foundations for the reform of the tax system in a liberalized environment, subsequent reports extended the roadmap for reforms to meet the demands of the emerging economic environment in the new millennium. These include the task force reports on the reform of direct and indirect taxes (India 2002) and the report of the task force on the implementation of the Fiscal Responsibility of Budget Management Act, 2003 (India 2004).

### **Tax Reforms Announcements – BUDGET**

Following are the areas under which changes related direct taxes mentioned in the budget;

- Tax rate **reduced to 25% for companies** with annual turnover up to Rs. 400 crore
- **Surcharge increased** on individuals having taxable income from Rs. 2 crore to Rs. 5 crore and Rs. 5 crore and

above.

- India's Ease of Doing Business ranking under the category of 'paying taxes' jumped from 172 in 2017 to 121 in 2019.
- **Direct tax revenue increased** by over 78% in past 5 years to Rs. 11.37 lakh crore

**Tax Simplification and Ease of living** – making compliance easier by leveraging technology:

- **Interchangeability of PAN and Aadhaar**
  - Those who don't have PAN can file tax returns using Aadhaar.
  - Aadhaar can be used wherever PAN is required.
- **Pre-filing of Income-tax Returns** for faster, more accurate tax returns
  - Pre-filled tax returns with details of several incomes and deductions to be made available.
  - Information to be collected from Banks, Stock exchanges, mutual funds etc.
- **Faceless e-assessment**
  - Faceless e-assessment with **no human interface** to be launched.
  - To be carried out initially in cases requiring verification of certain specified transactions or discrepancies.
- **Affordable housing**
  - Additional deduction up to Rs. 1.5 lakhs for interest paid on loans borrowed up to 31st March, 2020 for purchase of house valued up to Rs. 45 lakh.
  - Overall benefit of around Rs. 7 lakh over loan period of 15 years.
- **Boost to Electric Vehicles**

- Additional income tax deduction of Rs. 1.5 lakh on interest paid on electric vehicle loans.
- **Customs duty is exempted** on certain parts of electric vehicles.

## **Other Direct Tax measures**

- **Simplification of tax laws to reduce genuine hardships of taxpayers:**
  - The higher tax threshold for launching prosecution for non-filing of returns
  - Appropriate class of persons exempted from the anti-abuse provisions of Section 50CA and Section 56 of the Income Tax Act.
- **Relief for Start-ups**
  - **Capital gains exemptions** from sale of residential houses for investment in start-ups **extended** till FY21.
  - **'Angel tax'** issue resolved- start-ups and investors filing requisite declarations and providing information in their returns not to be subjected to any kind of scrutiny in respect of valuations of share premiums.
- **Funds raised by start-ups to not require scrutiny from Income Tax Department**
  - E-verification mechanism for establishing the identity of the investor and source of funds.
  - Special administrative arrangements for pending assessments and grievance redressal
  - No inquiry in such cases by the Assessing Officer without obtaining approval of the supervisory officer.
  - No scrutiny of valuation of shares issued to Category-II Alternative Investment Funds.
  - Relaxation of conditions for carry forward and set

off of losses.

- **NBFCs**

- Interest on certain bad or doubtful debts by deposit-taking as well as systemically important non-deposit taking NBFCs to be taxed in the year in which interest is actually received.

- **International Financial Services Centre (IFSC)**

- **Direct tax incentives proposed for an IFSC:**

- **100 % profit-linked deduction** in any ten-year block within a fifteen-year period.
- Exemption from dividend distribution tax from current and accumulated income to companies and mutual funds.
- Exemptions on capital gain to Category-III Alternative Investment Funds (AIFs).
- Exemption to interest payment on loan is taken from non-residents.

- **Securities Transaction Tax (STT)**

- **STT restricted only to the difference between settlement and strike price in case of exercise of options**

## **Recent Reforms**

**Reduction in corporate tax rate for all existing domestic companies:** In order to promote growth and investment, the Government has brought in a historic tax reform through the Taxation Laws (Amendment) Ordinance 2019 which provided a concessional tax regime of 22% for all existing domestic companies from FY 2019-20 if they do not avail any specified exemption or incentive. Further, such companies have also been exempted from payment of Minimum Alternate Tax (MAT).

**Incentive for new manufacturing domestic companies:** In order to attract investment in the manufacturing sector, the Taxation Laws (Amendment) Ordinance 2019 has drastically reduced the tax rate to 15% for new manufacturing domestic

companies if such company does not avail any specified exemption or incentive. These companies have also been exempted from payment of Minimum Alternate Tax (MAT).

**Reduction in MAT rate:** In order to provide relief to the companies which continue to avail exemption/deduction and pay tax under MAT, the rate of MAT has also been reduced from 18.5% to 15%.

**Exemption from income-tax to individuals earning income up to Rs. 5 lakh and increase in standard deduction:** Further, to provide complete relief from payment of income-tax to individuals earning taxable income up to Rs. 5 lakh, the Finance Act, 2019 exempted an individual taxpayer with taxable income up to Rs. 5 lakh by providing 100% tax rebate. Also, to provide relief to the salaried taxpayers, the Finance Act, 2019 enhanced the standard deduction from Rs. 40,000 to Rs. 50,000.

The Government is committed to provide a hassle free direct tax environment with moderate tax rate and ease of compliance to the taxpayers and also to stimulate the growth by reforming the direct taxes system. Some of the recent steps taken in this direction, apart from those discussed above, are as under:

**Personal Income Tax –** In order to reform Personal Income Tax, the Finance Act, 2020 has provided an option to individuals and co-operatives for paying income-tax at concessional rates if they do not avail specified exemption and incentive.

**Abolition of Dividend Distribution Tax (DDT) –** In order to increase the attractiveness of the Indian Equity Market and to provide relief to a large class of investors in whose case dividend income is taxable at the rate lower than the rate of DDT, the Finance Act, 2020 removed the Dividend Distribution Tax under which the companies are not required to pay DDT with effect from 01.04.2020. The dividend income shall be taxed

only in the hands of the recipients at their applicable rate.

**Vivad se Vishwas** – In the current times, a large number of disputes related to direct taxes are pending at various levels of adjudication from Commissioner (Appeals) level to Supreme Court. These tax disputes consume a large part of resources both on the part of the Government as well as taxpayers and also deprive the Government of the timely collection of revenue. With these facts in mind, an urgent need was felt to provide for resolution of pending tax disputes which will not only benefit the Government by generating timely revenue but also the taxpayers as it will bring down mounting litigation costs and efforts can be better utilized for expanding business activities. Direct Tax Vivad se Vishwas Act, 2020 was enacted on 17th March, 2020 under which the declarations for settling disputes are currently being filed.

**Faceless E-assessment Scheme** – The E-assessment Scheme, 2019 has been notified on 12th September, 2019 which provides for a new scheme for making assessment by eliminating the interface between the Assessing Officer and the assessee, optimizing use of resources through functional specialization and introducing the team-based assessment.

**Faceless appeals** – In order to take the reforms to the next level and to eliminate human interface, the Finance Act, 2020 empowered the Central Government to notify Faceless Appeal Scheme in the appellate function of the department between the appellant and the Commissioner of Income-tax (Appeals).

**Document Identification Number (DIN)** – In order to bring efficiency and transparency in the functioning of the Income Tax Department, every communication of the Department whether it is related to assessment, appeals, investigation, penalty and rectification, among other things, issued from 1st October, 2019 onwards are mandatorily having a computer-generated unique document identification number (DIN).

**Pre-filling of Income-tax Returns** – In order to make tax compliance more convenient, pre-filled Income Tax Returns (ITR) have been provided to individual taxpayers. The ITR form now contains pre-filled details of certain incomes such as salary income. The scope of information for pre-filling is being continuously expanded by pre-filling more transactions in the ITR.

**Encouraging digital transactions** – In order to facilitate the digitalisation of the economy and reduce unaccounted transactions, various measures have been taken which include reduction in rate of presumptive profit on digital turnover, removal of MDR charges on prescribed modes of transactions, reducing the threshold for cash transactions, prohibition of certain cash transactions, etc.

**Simplification of compliance norms for Start-ups** – Start-ups have been provided hassle-free tax environment which includes simplification of assessment procedure, exemptions from Angel-tax, constitution of dedicated start-up cell etc.

**Relaxation in the norms for Prosecution:** The threshold for launching prosecution has been substantially increased. A system of collegium of senior officers for sanction of prosecution has been introduced. The norms for compounding have also been relaxed.

**Raising of monetary limit for filing of appeal** – To effectively reduce taxpayer grievances/ litigation and help the Income Tax Department focus on litigation involving complex legal issues and high tax effect, the monetary thresholds for filing of departmental appeals have been raised from Rs. 20 lakh to Rs. 50 lakh for appeal before ITAT, from Rs. 50 lakh to Rs. 1 crore for appeal before the High Court and from Rs. 1 crore to Rs. 2 crore for appeal before the Supreme Court.

**Expansion of scope of TDS/TCS** – For widening the tax base,



several new transactions were brought into the ambit of Tax Deduction at Source (TDS) and Tax Collection at Source (TCS). These transactions include huge cash withdrawal, foreign remittance, purchase of luxury car, e-commerce participants, sale of goods, acquisition of immovable property, etc.

## **Tax Reforms announced by The PM**

PM Narendra Modi on Thursday launched the platform for **'Transparent Taxation – Honoring the Honest'** aimed at easing compliance and expediting refunds, benefiting honest taxpayers.

Three main features of the platform are

1. Faceless assessment
2. Faceless appeal
3. Taxpayers' charter

The PM said focus is on making the tax system people-centric and public friendly, **"banking the unbanked, securing the unsecured, funding the unfunded and honoring the honest."**

According to Modi, the four factors responsible for changes in the taxation system were:

1. Policy-driven governance
2. Belief in people's honesty
3. Advanced technology
4. Efficiency in bureaucracy.

"Where there is complexity, there is a problem in compliance," he added.

## **Taxpayer charter**

With the objective of enhancing the efficiency of the delivery system of the Income Tax Department, the Union Budget proposed to amend the provisions of the Income-tax Act to mandate the Central Board of Direct Taxes (CBDT) to adopt a Taxpayers'

Charter. The Finance Minister said, "The details of the contents of the charter shall be notified soon." She emphasized that any tax system requires trust between taxpayers and the administration. She further said that this will be possible only when taxpayer's rights are clearly enumerated.

The Income Tax Department had in 2014 made a citizens charter declaring their vision and mission to provide key services within definite timelines. The Taxpayers Charter furthers that vision with enhanced delivery standards and building trust with the taxpayer.

1. The Charter contains a commitment from the Department to accept a **taxpayer as honest and treat them in a fair manner**. Also, among other things prescribed in the law for representation and appeal by a taxpayer, the Department commits to provide complete information to a taxpayer.
2. The overall aim is to make the system of collecting and administering taxes less burdensome for a taxpayer.
3. Taxpayers must be treated as true customers of the income tax department, therefore recognition of their rights is an important part of the charter. With this spirit, the **charter states that a taxpayer shall be provided complete and accurate information, confidentiality shall be maintained and tax authorities shall be held accountable for their actions**.
4. The department will allow every taxpayer to choose a representative of their choice and provide a mechanism for **grievance redressal**. Taxpayers can also approach the Department for any issues or clarifications in compliance.
5. The Charter also expects taxpayers to comply with the **reporting requirements, maintain records and pay taxes within the due dates**.
6. Taxpayers should understand their tax obligations and

also respond to notices in a time-bound manner.

**Mould your thought** What are the implications of various tax reforms in India? Do you think they are meaningful in increasing tax compliance in India?