FUTURE OF INDIA'S TAX POLICY

SUDHIR KAPADIA

- The Narendra Modi government clearly aspires to create large scale transformation in social welfare and social capital.
- Initiatives in public infrastructure, steps such as digitisation, formalisation of the economy including demonetisation, the resolve to address rising bad debts in banking bear this out.
- Time to embrace bolder tax initiatives – eliminate a plethora of incentives and deductions, moderate rates, significantly reduce tax controversies and resultant litigation and kick-start an economic revival like in the USA.

AN OVERVIEW:

Tax policy in India has been a subject matter of great attention and debate in the context of the aspiration to have faster economic growth, create more employment and lift more people out of poverty. Given the seemingly contradictory objectives of growth with equality and the need to balance a moderate tax system with increase in the tax base, it is no surprise that there are divergent views on the future course for India's tax policy. However, there has been a reasonable consensus (both said and unsaid) on the need to maintain moderate rates of direct taxation since the late 1990s. Undoubtedly, the ushering in of overall far reaching economic reforms in the early 1990s impacted the subsequent thought processes as far as tax policy was concerned. One of the early policy directions in this regard came from the Kelkar Committee which for the first time unveiled far reaching reforms agenda for indirect taxation which finally culminated in the introduction of the Goods and Services Tax (GST) well over a decade later. The Kelkar Committee recommendations also found an echo in an earlier (failed) attempt to revamp India's Direct tax (DT) law until recently when a fresh attempt was made to revisit the direct tax law in line with international best practices, while keeping in mind India's own economic needs. At the time of writing this piece, the Expert Committee set up for suggesting the new DT law is drafting its final recommendations.

ANALYSIS & DISCUSSIONS:

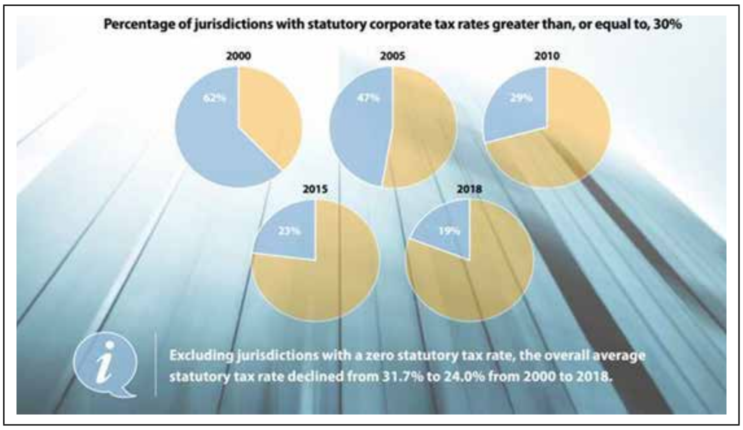
To come specifically to the point of economic and fiscal agenda of the Modi Government, we have witnessed a clear desire to aspire for a large scale transformation in the space of social welfare and social capital. This is borne out by the initiatives taken in the areas of public (especially rural) infrastructure, accessibility to gas connections, supply of electricity, construction of toilets, affordable houses and universal banking. The overarching initiative has been the steps taken towards digitisation and formalization of the economy. This has been accompanied by a desire to find a resolution to the mounting bad debts in the banking sector through the introduction of Insolvency and Bankruptcy code (IBC). With recent adversarial global developments namely US trade policies, firming up of crude oil prices and early challenges to global growth, the Finance Minister has an unenviable task of maintaining the target fiscal deficit below 3.5 percent as well as the target growth rate of over 7 percent of the economy in 2019-20. It is fair to state that just like the private sector, the modern government today also has to function in a world characterized by volatility, uncertainty, complexity and ambiguity of economic and fiscal conditions (VUCA). An interesting question which, therefore, arises is the course India should take with regard to overall tax policy in such VUCA times. This article attempts to outline some suggested policy interventions to help address some of these seemingly conflicting and intractable challenges which any government of the day is likely to face in the evolving area of tax policy.

1. **Simplification of Tax Laws** – Though this has been used as a cliché many times, the fact of the matter remains that direct tax law has become too complex with a plethora of cumulative amendments and clarifications. In the case of the GST law, there has been understandably an evolutionary process in place as more and more clarifications are sought to be addressed. Be that as it may, there is an urgent need for technical capacity building in the Revenue department to facilitate real time clarifications on contentious technical issues as and when they arise. At the same time, such clarifications should be commercially pragmatic and not devoid of business realities. Here, the quality of the legislation as well as changes thereto is equally critical so as to avoid ambiguity as far as possible. Whilst good attempts have been made in providing clarifications on many legacy issues, it is felt that enhancement in the technical strength of the Revenue Boards is required to keep pace with the changes in business and the issues which keep arising.

2. **Reduction in Tax Litigation** – Along with the need to legislate better and clarify sooner than later, there has to be a concerted attempt to reduce the plethora of accumulated tax cases at various levels and to also ensure that unnecessary litigation does not get initiated. Here, there is a need for innovative and bold ideas for settling cases at an early stage itself at the assessment or first appellate level and only those cases should be allowed to travel to the courts where finer interpretation of the law is involved. This needs a paradigm shift not just in the thought of the Revenue department but the tax payers as well. Since, by all accounts, a majority of the tax revenues get collected through advance taxes and tax deducted at source (TDS), it would be beneficial to the Revenue if fewer business tax returns are selected for scrutiny and the quality of the audit is improved without jeopardizing the interest of the Revenue. This, by itself, will result in considerable streamlining of tax controversy and litigation.

3. **Enabling Tax Policy for Growth** – Whilst the current tax law is full of legacy incentives and exemptions towards certain economic development goals, time has now come to streamline and eliminate most of these legacy exemptions and focus on just a few (e.g., R&D or innovation related). This will give some elbow room to the Government to finally bring down the business tax rate to a uniform 25 percent as was promised way back in 2014. In this connection, it is useful to bear in mind that there has been a progressive moderation in corporate tax rates globally due to increase in competition in attracting investments. An analysis below brings out this phenomenon quite starkly.

Exhibit 23: India's Corporate Tax Rate is Already High



Source: OECD Corporate Tax Statistics Database, 2019

Exhibit 24: Corporate Tax Rate Trend Globally

Global corporate tax trend

Jurisdiction	Corporate Tax Rate (2005)**	Corporate Tax Rate (2016)**
India	36.6	34.6
G20	31.5	28.6
OECD	28.2	25

** Simple average

Source: OECD Corporate Tax Statistics Database, 2019, India Budget Documents.

- In the United Kingdom, further phased reductions in the corporate tax rate to 17% and then to 15% are planned in the next three years.
- The US has reduced the corporate tax rate down to 21% and introduced territorial system of taxation with participation exemption.
- Singapore applies a tax rate of 17%.
- Vietnam and Thailand have corporate tax rates at 20%.

It is interesting to note that as per the OECD Database of Corporate Tax Rates, of the 94 jurisdictions covered, India has the highest statutory tax rate at 48.3%, which includes a tax on distributed dividends. USA, till recently, was the second highest at 43 percent. As is now well known, the US has brought down its corporate tax rate to 21 percent and has, thus, jumped several places to become one of the most attractive jurisdictions from a tax rate perspective.

Similarly, there is a case for substituting the Minimum Alternate Tax (MAT) on companies with the far simpler Alternate Minimum Tax (AMT). The current scheme of MAT has resulted in innumerable interpretations specially due to the fast changing principles of accounting and the link between the MAT provisions and the books of accounts has resulted in unnecessary taxation on notional income basis. All these measures will necessarily require a steady expansion of the tax base in India and an increase in the tax GDP ratio.

The Revenue Department has initiated a number of non- intrusive analysis based measures to try and assess the 'tax gap'. In other words, there are serious attempts to ensure that a potential tax in a particular sector is duly collected if it is found on the basis of data with the Revenue that the requisite tax has not been paid by that sector. However, the system of setting revenue targets for tax officers is still archaic and is simply based on incremental targets which are not necessarily aligned to a proper tax gap analysis and potential for collecting tax revenue in a particular sector/location.

CONCLUSIONS:

All in all, time has come for India to embrace a bolder tax policy initiative by reposing a lot more trust with the taxpayers, making business tax assessments as non-intrusive as possible, enhancing technical capacity to be able to give clarifications on technical issues on a real time basis, streamlining and eventually eliminating a plethora of incentives and deductions, moderating tax rates and significantly reducing tax controversies and resultant litigation. It is hoped that the Government will see this opportunity of tax reforms kick starting the levers of the economy.