



Policy Watch - Direct Tax Code

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Recently, a draft legislation on new direct tax code has been submitted by the task force to the Finance Minister. The task force headed by **Akhilesh Ranjan**, was constituted in **Nov 2017** to review the existing Income Tax Act 1961.

The draft legislation submitted, proposes far reaching changes and significant relief to taxpayers. It also proposes incentives to start-ups and a new concept of settling disputes through mediation between taxpayer and collegium officer.

Why new tax code?

- Income Tax Act, 1961, was constituted and enacted considering the need and state of the economy at that time, taking into account the mindset and thought process of the people about how income could be taxed.
- Over the last 58 years, the economy has become more integrated, globalised, liberalized and new models of business have arisen. Therefore, the act needs to be redrafted and be made accommodative of the needs of the present as well as of the next few decades.

Challenges in Direct Tax System

- **Tax Rate:** The tax rate in India is quite high for both individual as well as corporate.
 - The reduction in corporate tax rate by Trump administration has led to the shifting of investment from other regions to USA.
 - However, the government had reduced the corporate tax rate to 25% but treating of domestic and foreign companies at par is an issue which needs to be resolved.
 - The individual tax rates also need to be rationalized in order to increase the tax base.
- **Tax Assessment:** In India, the assessment process is physical which leads to allegation of harassment by tax officials often referred to as tax terrorism.

This is a major roadblock in compliance and increasing the tax base.
- **Tax Dispute:** In Indian taxation system, there have been huge number of tax litigations, which makes the whole tax dispute resolving mechanism unviable.

This is a major cause of concern in ease of doing business and enforcing contracts.
- **Exemptions:** There are a plethora of exemptions in direct tax code which makes the filling process more complex and reduce the effective tax rate.

Relevance of New Direct Code

- **Complexities:** The six decade old tax code consists of around 700 sections of very complex nature. It has evolved over the time taking into account many amendments. Now the whole tax code has assumed a very haphazard form.

Therefore, simplification of tax laws would enable more people to become the part of direct tax regime.
- **Demographics:** In the country of more than **1.2 billion**, there are only **74 million** effective taxpayers which is a very shallow figure.

Considering the scale of Indian population and demographics, tax administration needs to take proactive steps in bringing more people within the tax-fold.

- **Tax Administration:** The present tax administration has evolved taking into account the experience it has gained in the past 6 decades.
Therefore, the new tax code provides an opportunity to remove procedural loopholes and make the tax administration user friendly, which is presently infamous for harassment.
- **Use of Technology:** In 1961, the taxation process was completely physical. Now the use of new technology, social media, artificial intelligence has to be accommodated to make the process more simpler and transparent.
Recently, the Income Tax department started the **faceless assessment** scheme on a pilot basis.
- **Changing Form of Business:** In past 6 decades, the nature of business has evolved a lot. The social media and internet marketing has become a new commodity which needs to be appropriately taxed.
Therefore, the new tax code should involve provisions for taxing stakeholders beyond the geographical boundaries.

Faceless Assessment: It is a randomised and anonymised assessment, aims to eliminate physical interface between taxpayer and tax assessee.

- In this system, one need not appear before a tax officer and there is no physical movement of papers or person.
- It will reduce a lot of pressure and address issues faced by tax administration during assessment.
- The need is to make the faceless or e-assessment widespread and mandatory.

Expectation from New Tax Code

- Abolition of Dividend Distribution Tax (DDT) and Minimum Alternate Tax (MAT).
- Abolition of cess and surcharges.
- Minimization of exemptions.
- Simplification of tax laws.
- Tax-payer friendly administration.

What New Direct Tax Code means for Stakeholders?

- **Individuals:** The difference between the cost of tax evasion and tax compliance is not very much. People due to fear of harassment do not enroll into tax system but they pay the cost illegally in form of bribe.
Therefore, they can be easily moved towards tax compliance by simplifying tax laws and making administration taxpayers friendly

- **Corporate:** Uniform tax rate for both local and foreign companies propel ease of doing business in India thus increasing business activity in the country.
Therefore, the new direct tax code provides an opportunity to overhaul the whole investment scenario in the country.
- **Economy:** The macro dimension added in the past few decades has made our economy more integrated with the rest of the world in terms of trade and investment.
 - The mobility of capital across the geographical boundaries has increased immensely and tax competition among countries has also become intense. There is also an international context to our tax policy.
 - Therefore, the DTC has the potential to boost the entire macro-cycle in the economy by boosting the tax base and collection, thereby increasing the tax-to-gdp ratio.

Way Forward

- For the sake of administrative convenience, we have focussed on the ability to pay, the tax law seldom tries to differentiate between high risk income and low risk income, legal income or illegal income, recurring income or non-recurring income . These nuances are difficult to administer but will bring more equity to the system.
For Example: Income from government-securities and government job is highly secured while income from business is very risky, therefore, they must be taxed differently.
- The very effort of the planners should be to boost income i.e to be taxed, to boost the base of wealth that creates income. Therefore, special consideration should be given to wealth creators.
- The new tax code provides an opportunity to build a predictable tax regime which will attract long-term investment and lead to job creation.
- Indian taxation system is plagued by litigations in courts, therefore the new tax code must aims at reforming the dispute resolution mechanism by introducing a system of mediation or settlement.

It is believed that whenever the country goes for a new tax code, it basically means to rationalise the tax rate and exemptions, therefore the risk of tax forgone in short term is quite high. Before implementing the new tax code, the country needs to stabilize the GST regime and ensure that the economy is in good state to absorb short term disruptions.