

Income tax reforms: Will the review deliver on promises?

Gautam Nayak 26th August 2024

In the budget for 2024-25, Union finance minister Nirmala Sitharaman had announced a comprehensive review of the Income Tax Act, aiming to make it concise, lucid and easier to understand.

According to Sitharaman, with these reforms the finance ministry seeks to reduce disputes and litigation, providing tax certainty to taxpayers.

While all these objectives are commendable, the key question is whether the procedure being followed will achieve the desired results.

In line with this announcement, the chairman of the Central Board of Direct Taxes (CBDT) said that an internal committee of Income Tax Department has been established to review redundant clauses and adopt best global practices to simplify the Act for taxpayers.

The panel is also looking at eliminating redundancies and identifying outdated clauses that can be removed. It aims to find the “best way forward” for implementing a new direct tax law for the country.

While the goals of this exercise are commendable, past experience offers little hope. Many such committees—some consisting of solely of tax officials, while others including both experts and officials—were set up but rarely saw the recommendations being implemented.

Committees with external experts and tax officers had produced some of the most comprehensive reports, but their excellent suggestions were seldom acted upon by government.

On the other hand, internal committees set up for this purpose often produced recommendations favouring the tax department and focussed only on overruling decisions that went against the tax department, but failed to address issues holistically.

This was likely due to the committees’ lack of practical experience with the challenges faced by corporates and individuals in complying with tax laws. Besides, the suggestions reflected a bias with tax officials often viewing taxpayers as evaders and prioritising revenue maximization.

Unfortunately, many recommendations were accepted and implemented, increasing the compliance burden on taxpayers, leading to more litigation.

If the government is serious about creating a balanced law that curbs tax evasion and facilitates compliance, while being fair to genuine taxpayers, it must involve retired judges, experts, corporates, professionals, and individual taxpayers with deep knowledge of tax laws.

These stakeholders should be included both in the committee as well as in the consultative process to ensure that the resulting suggestions facilitate the development of a world-class tax law. We have the necessary knowledge and experience both within and outside the tax department. The key is to strike a fair balance between the two, beginning with the composition of the committee.

An argument against a consultative process is that the finance minister's December-end deadline may not allow sufficient time for thorough consultations. However, the priority should be a genuinely balanced tax law, which can only be achieved if all stakeholders are involved.

Perhaps the need to implement the changes in the next budget necessitated the short timeline for this exercise. However, it will be far better to ensure a comprehensive approach rather than a hurried, half-baked solution that may not be effective in reducing litigation.

One can only hope that this aspect will be considered and the process will be modified accordingly.

Another aspect to consider is that whether frequent changes to the tax law have made it more complex and prone to litigation. Even a well-crafted law can become unfair and complicated if the government and tax department continually amend it to address every loophole, even when misuse is minimal.

Therefore, could there be a committee of internal and external experts to evaluate whether such amendments are genuinely necessary each year before they are enacted?

In conclusion, a fair, simple and balanced law can only be achieved if there is a change in the mindset of those responsible for suggesting the changes, both now and on an ongoing basis.

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