INCOME TAX BILL, 2025 - ECONOMY

NEWS: Both houses of the Parliament passed the Income Tax Bill, 2025, which seeks to simplify, rationalise, and shorten the existing Income Tax 1961 Act**.**

Definition of Virtual Digital Space

The Bill introduces a comprehensive definition of "virtual digital space", covering all forms of digital environments such as email accounts, social media platforms, websites, cloud servers, online accounts, and other digital platforms. By including such a wide scope, the law ensures that tax authorities have jurisdiction over digital activities that may conceal taxable income or aid tax evasion.

Access for Tax Authorities

If the definition is retained, tax authorities may be empowered to access or bypass passwords for digital platforms in order to investigate potential cases of tax evasion, misreporting, or under-reporting of income. This would also imply that companies managing such platforms could be legally required to assist tax authorities in providing access or facilitating investigations.

Uniform 'Tax Year'

The Bill proposes to replace the dual concepts of 'assessment year' (the year following the financial year in which income is assessed) and 'previous year' (the year in which income is earned). Instead, it introduces a single 'tax year', uniformly defined as the period from 1st April to 31st March, simplifying compliance and reducing legal ambiguity for taxpayers.

Exemption on TCS for Education Remittances

The Bill clarifies that Tax Collected at Source (TCS) will not be applicable on amounts remitted under the Liberalised Remittance Scheme (LRS) for educational purposes. This exemption applies when such remittances are financed through loans from financial institutions, thereby reducing the financial burden on students and families pursuing higher education abroad.

Nil TDS Certificate for Individuals without Tax Liability

Individuals who have no tax liability can now proactively apply for a nil Tax Deduction at Source (TDS) certificate. This advance certification will help avoid unnecessary deduction of tax from their income, ensuring ease of compliance and faster access to full earnings.

Alternate Minimum Tax (AMT) for LLPs

The Bill aligns the applicability of Alternate Minimum Tax (AMT) for Limited Liability Partnerships (LLPs) with the provisions already existing under the Income Tax Act. AMT ensures that entities or individuals who claim multiple tax deductions and exemptions still pay a minimum level of tax, thereby preventing complete tax avoidance.

Nature of Income Tax

Income Tax is classified as a direct tax, levied directly on the income of individuals, companies, or other taxable entities during a financial year. For individual taxpayers, it is structured according to progressive tax slabs, meaning that higher income earners are charged at higher rates. The applicable slabs may vary depending on whether taxpayers opt for the new simplified tax regime or continue under the old regime with deductions and rebates.

How is the Tax System in India?

Taxes are mandatory financial charges or levies imposed by a government on individuals, businesses, or property to fund public services and government operations. There is no quid pro quo between the tax payer and the public authority. The Tax System in India consists of a mix of Direct Taxes, Indirect Taxes and Other Taxes.

Types of Taxes

1. **Direct Taxes** – They are paid by individuals or entities to the government and cannot be transferred to others.
2. **Indirect Taxes** - They are levied on goods and services, collected by intermediaries from consumers at the point of sale, and remitted to the government.
3. **Other Taxes** – These taxes are levied for specific purposes, often funding infrastructure or welfare programs.

1. Direct Taxes

1. **Income Tax** - It is imposed on income that is progressive in nature, with different slabs for various taxpayer categories.
2. **Capital Gains Tax** - Tax on gains from investments, with different rates for short-term and long-term holdings.
3. **Securities Transaction Tax** - Tax on transactions involving securities in the stock market.
4. **Perquisite Tax** - Tax on benefits provided by an employer to employees (e.g., housing, cars).
5. **Corporate Tax** - Tax paid by companies on their earnings, with different slabs for various income levels.
6. **Minimum Alternative Tax (MAT)** - MAT ensures companies pay a minimum tax, set at 18.5%.
7. **Fringe Benefit Tax (FBT)** - Tax on non-cash benefits provided by employers (abolished in 2009).
8. **Dividend Distribution Tax (DDT)** - Tax on dividends paid by companies.
9. **Banking Cash Transaction Tax** - Tax on banking transactions (abolished in 2009).

2. Indirect Taxes

1. **GST -** A consumption-based tax on value-added goods and services (ad valorem tax), levied at each stage of the supply chain. It is regressive in nature as it is imposed at the same rate on all individuals irrespective of income.
2. **Value Added Tax (VAT)** - Tax on goods sold, applied at each stage of the supply chain. It is imposed on goods that are excluded from the GST regime like alcoholic beverages, petroleum products etc.
3. **Custom Duty & Octroi** - Taxes on imported goods (Custom Duty) and on goods crossing state borders (Octroi).
4. **Excise Duty** - Tax on goods manufactured within India.

3. Other Levies (Cess)

1. **Education Cess** - A 2% tax to fund educational initiatives like developing classrooms, libraries, providing scholarships etc.
2. **Swachh Bharat Cess** - Tax introduced in 2015 to fund cleanliness initiatives like Swachh Bharat Mission.
3. **Krishi Kalyan Cess** - Tax introduced in 2016 to support agricultural welfare like irrigation projects, subsidized seeds etc.

What is the Goods and Services Tax (GST)?

GST is a value-added tax applied to goods and services for domestic consumption. It is an indirect tax i.e., while consumers pay the GST, it is collected and remitted to the government by the businesses selling the goods and services.

Legislative Basis

The 101st Amendment Act, 2016 established the GST system by introducing a single indirect tax regime for the entire country by subsuming various taxes. Central taxes subsumed under GST are Central Excise Duty, Additional Excise Duties, Service Tax, etc. State taxes subsumed under GST are State VAT (Value Added Tax), Central Sales Tax, Luxury Tax, etc.

Main Features

Supply Side: GST applies to the supply of goods and services, unlike the old tax on manufacturing, sale, or provision.

Destination-Based Taxation - GST follows destination-based consumption taxation, unlike the origin-based system.

Dual GST - Both the Centre (CGST) and States (SGST) levy tax on a common base. Imports of goods or services are treated as inter-state supplies and are subject to Integrated Goods & Services Tax (IGST) along with applicable customs duties.

GST Council - CGST, SGST, and IGST rates are mutually decided by the Centre and States, based on the GST Council's recommendations. Article 279A establishes the GST Council, headed by the Union Finance Minister and comprising state-nominated ministers. The Centre holds 1/3rd voting power, while states have 2/3rd, with decisions made by a 3/4th majority. GST is levied at five rates i.e., 0% (nil-rated), 5%, 12%, 18%, and 28%, with item classifications determined by the GST Council.

What are the Challenges in the Current Taxation System?

Retrospective Taxation - The 55th GST Council's recommendation for a retrospective tax amendment is a regressive move that disregards Supreme Court (SC) rulings. The ill-advised retrospective amendment to nullify the Vodafone verdict resulted in an international penalty of Rs 8000 crore, which India had to pay. In 2014, the former Finance Minister Arun Jaitley termed retrospective taxation "tax terrorism". This erodes investor confidence and discourages long-term investments, as companies cannot rely on consistent rules.

Revenue Maximisation - The GST Council's single-minded focus on maximizing revenue results in arbitrary and exaggerated tax demands, leading to business frustration and inefficiencies.

Input Tax Credit Denial - Denying businesses input tax credit, particularly in sectors like real estate, is economically detrimental. This increases the final price for consumers, distorts market competition, and dampens sectors that could stimulate growth. In the *Chief Commissioner of Central Goods and Service Tax & Ors. Vs Safari Retreats Case, 2024*, the SC ruled that the real estate sector can claim Input Tax Credit (ITC) on construction costs for commercial buildings used for renting or leasing purposes that was earlier not allowed.

Complicated Tax Structure - The multiple tax rates in both indirect and direct taxes, complex tax notifications, complicated system of exemption and concessions, and circulars create an environment that benefits tax professionals rather than businesses.

Low Direct Tax Collection - Corporations, particularly multinationals, use transfer pricing to shift profits from high-tax to low-tax jurisdictions, reducing their tax liabilities. Some corporations underreport their income or overstate their expenses to reduce their tax liability. Such low direct tax collection forces the government to generate revenues from other sources like high indirect tax rate, surcharge, and cess.

What are the Consequences of Complex Tax Structure?

Imports Dependency - A burdensome tax system makes domestic manufacturing less competitive compared to imported goods, leading to over-reliance on foreign products. E.g., imports from China increased from USD 70 billion in 2018-19 to USD 100 billion in 2023-24. It also leads to inverted duty structure where the rate of tax on inputs used is higher than the rate of tax on the finished goods. The share of manufacturing in India's GDP has fallen below 15%.

Currency Depreciation - As businesses face higher costs, reduced competitiveness, and suppressed growth, it leads to weakening of the Indian rupee and escalating the trade deficit. It can lead to twin account deficits when a country has both a fiscal deficit and a current account deficit.

Investment Discouragement - A complicated tax system, with unclear structures and retrospective amendments, creates uncertainty for investors and negatively impacts ease of doing business.

Lower Revenue Collection - Businesses struggle to navigate the complex tax system, resulting in either underreporting or tax evasion. Lower revenue collection forces the government to resort to higher taxes to meet fiscal targets, which leads to a cycle of stagnation.

Downward Economic Spiral - Lower growth, reduced investment, and rising imports create a vicious cycle that undermines long-term economic stability and perpetuates inefficiencies.

Way Forward

Streamline GST - A more simplified and uniform tax rate structure should be introduced to ensure ease of doing business, especially in sectors like real estate and infrastructure. India must focus on simplifying the tax framework by rationalizing rates. E.g., three GST rates on popcorn i.e., Unlabelled (5%), Labelled ready-to-eat (12%) and Caramelized (18%).

Tax Certainty - Avoid frequent amendments or arbitrary tax demands that are essential to establish clear and consistent tax rules. End retrospective taxation that has been detrimental to investor confidence.

Optimize Revenue Collection - Leverage digital platforms and artificial intelligence to improve tax collection efficiency and prevent evasion. Technology can help in identifying tax anomalies, ensuring businesses report accurately, and preventing underreporting.

Focus on Economic Growth - The tax system should prioritize long-term growth over revenue maximization, as a growth-oriented policy expands the tax base in the future. Improving Corporate Tax Collection: Conduct regular and thorough audits of corporate tax filings to identify potential underreporting, evasion, or fraud. Offer incentives like early payment discounts or lower penalties for early voluntary disclosures of tax errors or omissions to encourage companies to pay taxes on time.

Current Trends in Tax Collections - According to the Central Board of Direct Taxes (CBDT), India's gross direct tax collections for FY 2025-26 stood at ₹7.99 lakh crore. This represents a 1.9% decline compared to ₹8.14 lakh crore collected in FY 2024-25, indicating possible economic slowdown, reduced corporate profitability, or moderation in income growth as underlying factors.

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