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DIRECT TAX CODE: SINE QUA NON

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CONTENTS

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[Abstract: *The taxes are an indispensable part of the revenue for the Government of India and presently there are two major types of taxes which are direct and indirect. There are various legislations governing the taxation structure in specific the direct tax but these have been inefficacious because of many causes such as complicated compliance, multiplicity of tax, high exemptions granted, complex drafting and specific tax problems including tax cascading and tax havens. To get to the bottom of these problems, the Government has formulated a new initiative known as Direct Tax Code. The code proposes to simplify and consolidate all the existing legislations including Income Tax Act, 1961 and Wealth Tax, 1957. Though considerations have been taking place on this matter since 2010 but it is not implemented till date. This paper proposes to identify the main reasons for contriving the code and also why it has not been executed so far. Also, the Tax structure not only affects one entity but all the economic shareholders including the Individuals, corporations and the economy thus comprehending the impact of code on them can assist in drafting of the code. The author also points out the major structural weaknesses which the implementation part may face such as Black money, Tax Haven countries and minimal number of taxpayers as compared to the population of the nation. A study of the country Estonia has been taken into consideration because it has been ranked one of the tops in the Tax Competitiveness report, 2022. The paper also suggests some provisions which should be incorporated in the Code as the Government is contemplating to present the new Direct Tax Code in the Budget session of 2023.***]**

Keywords: *Direct Tax, Direct Tax Code, Income Tax Act,1961, Estonia, Tax Competitiveness Report*

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I

INTRODUCTION

The ability to tax people and their property is crucial to the government's basic survival. Role of taxation in any scheme of financing economic development is well recognized. Economic development of any country depends to a large extent on the proper mobilisation and efficient use of such resources by ensuring rational allocation between different sectors of the economy.[1] Taxes are a significant and substantial source of government revenue. The government allocates tax revenue to a variety of national development programmes. The Indian tax system features a three-tier federal structure consisting of the central government, state governments, and local municipal entities. Additionally, India has both direct and indirect taxation. An individual or organisation pays a direct tax directly to the entity that levied it. Examples of direct taxes include income tax, real property tax, personal property tax, and taxes on assets, all of which are paid by an individual taxpayer directly to the government, whereas indirect taxes include value-added tax, service tax, Good and Service tax, and customs duty, among others. The major propositions of the code are also highlighted through the paper.

Direct taxation is crucial to India's tax structure, as it is one of the government's primary revenue sources. The figures of Direct Tax collections for the FY 2022-23, show that net collections are at Rs. 7,00,669 crores, compared to Rs. 5,68,147 crores in the corresponding period of the preceding Financial Year i.e., FY 2021-22, representing an increase of 23%.[2] It also demonstrates the significance of taxes by lowering economic disparities through a progressive tax framework. Citizens are taxed proportionally to their economic status, so promoting social and economic equality. Moreover, with direct taxes, taxpayers are informed of how much tax they will owe in a given fiscal year and may plan accordingly. Any change in their rates can assist in managing the economy's demand and supply, making direct taxes effective for containing inflation. Current Direct tax legislation includes the Income Tax Act, 1961, the Wealth Tax Act, 1957, the Gift Tax Act, 1958, Corporate Tax, capital gains tax, property tax, entitlement tax, etc., but they

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[1] Pradip Kumar Das, *A study of direct taxation in India,* VI Direct Res. Social Sci.Edu. Studies 103 (2019).

[2] Income Tax India, *Gross Direct Tax collections for the Financial Year (FY) 2022-23* (18 Sep., 2022), *available at-* https://incometaxindia.gov.in/Lists/Press%20Releases/Attachments/1103/Press-Release-Gross-Direct-Tax-collections-for-the-Financial-Year-2022-23-dated-18.09.2022.pdf (last visited 18 Sep., 2022).

are extremely complex and virtually unintelligible to the common man due to a difficult structure, numerous amendments, frequent policy changes, and a multitude of judgments that gave varying interpretations to provisions that were already incomprehensible. Accordingly, Government in 2010 came up with a Direct tax code which aims to consolidate and amend all laws relating to the direct taxes namely, income-tax, dividend distribution tax, fringe benefit tax and wealth-tax in order to facilitate voluntary compliance, increase the tax-GDP ratio and establish an economically efficient, effective and equitable direct tax system which will facilitate voluntary compliance and help increase the tax-GDP ratio.[3] It will eventually pave the way for a single unified taxpayer reporting system. The aim of New Direct Tax Code (DTC) is to make the current tax structure in India straightforward and easy to understand.[4] In planning and designing an ideal Income Tax Structure for a welfare state like ours, the goals are to provide relief to the lowest and middle-income taxpayers to the greatest extent possible and to prevent the creation of black money, on the one hand, and to enable the government to increase tax revenue collection for development projects, on the other. But it can be stated that The Direct Taxes Code (hereafter referred to as the 'Code') is not an attempt to amend the Income Tax Act, 1961; nor is it an attempt to "improve" upon the present Act. In drafting the Code, the Central Board of Direct Taxes (the Board) has, to the extent possible, started on a clean drafting slate. Some assumptions which have held the ground for many years have been discarded. Principles that have gained international acceptance have been adopted.[5]

This paper highlights the need of direct tax code in India's present tax structure, its major provisions, its implication on the various stakeholders of the economy, what can be expected from the upcoming Direct Tax Code (DTC) and also providing a case study of Estonia's Tax system which is ranked to have best Taxation structure.

II

BACKGROUND AND NEED OF A DIRECT TAX CODE IN INDIA

India, like many other modern nations, has a well-developed and diverse tax framework, with the Central Government and State Governments sharing the

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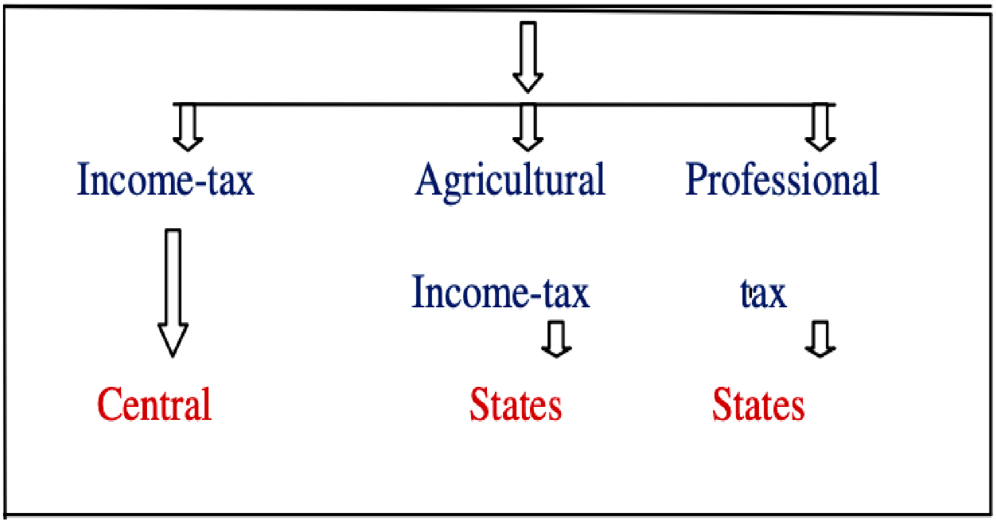
[3] Dr. Kamal Pant & Ashish Arya, *Assessee perception towards Direct Tax Code (DTC),* II IJMBS (2012).

[4] Dr. Taral kumar Pinakinbhai Bhatt, *Effect of New Direct Tax Code (DTC) on Income Tax Act 1961,* VI IJRAR (2019).

[5] Dr. Kamal Pant & Ashish Arya, *Assessee perception towards Direct Tax Code (DTC),* II IJMBS (2012).

right to impose taxes. Direct taxes are mostly the responsibility of the central government, with the exception of the professional tax and the agricultural income tax, whereas indirect taxes may be imposed by both the central government and the states. Direct taxation in India is represented below:



Despite India's well-structured taxes, the system has some serious flaws, including:

1. Complicated compliance: The compliance that must be met under several statutes, such as the Income Tax Act of 1961, etc., make tax payment a monumental burden for taxpayers.

2. Cascading of Tax: A cascade tax or cascading tax refers to a system that imposes sales taxes on products at each successive stage in the supply chain from raw material to consumer purchase. Each buyer in the supply chain pays a price based on its cost, including the previous tax or taxes that have been charged.[6] For example, if the government levies a 1% tax as cascade tax on all goods produced and supplied. Then for instance, a slab of stone cost Rs. 100 but is sold to an artist at a price of Rs. 101. The artist prepared a product out of the stone slab and is willing to a profit of another Rs.100. So, the artist will sell the product to the dealer at a price of Rs. 203 [(Rs. 101 + profit desired of Rs.100) +1 of this total amount). The art dealer suppose wants to make a profit of Rs. .500, so the end price at which the product is sold results as Rs.811. Thus, the problem is that government instead of earning a 1%

[6] Julia Kagan, *Cascade Tax* (Dec. 18, 2020) *available at*- https://www.investopedia.com/terms/c/cascade-tax.asp#:~:text=A%20cascade%20tax%20or%20cascading,taxes%20that%20have%20been%20charged (last visited 21 Aug., 2020).

tax instead earns a total of nearly 2% tax which is double. This problem can be solved by Direct Tax Code.

3. Exemptions or concessions extended to several products or categories of producers: In India, agricultural revenue is free from taxation. The State List in the Seventh Amendment's Schedule VII grants states the ability to tax agricultural revenue. Taxpayers seek to claim a wide variety of income under the pretence of agricultural income.
4. Multiplicity of Taxes: Due to Multiplicity of taxes there is unhappiness among citizens of India regarding tax structure. Taxes by the Union Government, State Governments and the local governments have resulted in difficulties and harassment to the taxpayer. He has to contact several authorities and maintain separate records for each of them. An Ideal Tax system must follow Adam smith's canons of taxation but due to over dependence on indirect taxes, the tax system suffers from the problems like Inequality, regressive, uneconomical, inflationary, etc.[7] The taxes which are levied by Union Government alone includes Custom tax, Excise tax, Services tax and most importantly the Income tax. The State government imposes tax such as central sales tax, VAT, Stamp duty, thus a simplified tax structure is required because the complexity discourages individuals from paying taxes.
5. Complex Drafting: As a result of the convoluted language of its sections and requirements, the Income Tax Act of 1961 is difficult to grasp and comprehend, which provides a justification for noncompliance with the law.

To streamline and combine the current legislation on 12 August 2009, the Government of India issued the first draught bill of DTC for public comment along with a discussion paper (DTC 2009). In 2010, a revised discussion paper (RDP) was issued in response to comments from various stakeholders. DTC 2010 was introduced in the Indian Parliament in August 2010, and a Standing Committee on Finance (SCF) was specifically formed for the purpose. On March 9, 2012, the Standing Committee on Finance submitted its report to the Indian Parliament after extensive consultation with various stakeholders. After the committee's findings, an updated version of the code was generated later in 2014. However, the law expired due to a change in government following

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[7] Nishant Ravindra Ghuge & Dr. Vivek Vasantrao Katdare, *Indian Tax structure - An analytical perspective,* III IJMSS (2015).

the 2014 general election. A new expert group was created in 2017; it delivered its report to the finance minister in 2019; and the government is planning to implement a new Direct Tax Code as soon as possible.

III

IMPORTANT PROVISIONS OF DIRECT TAX CODE

The important provisions of Direct Tax code of 2010 are as follows:

1. It aims to consolidate various acts including the Estate Duty Act, 1953; inheritance (Abolished), the Expenditure-tax Act, 1987 (Abolished), the Wealth-tax Act, 1957; (abolished), the Income-tax Act, 1961; the Super Profits Tax Act, 1963, the Prohibition of Benami Property Transactions Act, 1988; Chapter VII of the Finance (No. 2) Act, 2004; (securities transaction tax), Chapter VII of the Finance Act, 2005 (banking cash transaction tax) – Abolished, Chapter VII of the Finance Act, 2013; (commodity transaction tax), he Black Money (Undisclosed foreign Income and Assets) and Imposition of Tax Act, 2015; Chapter VIII of the Finance Act, 2016; or (Equalization levy), Gift Tax Act, 1958 (abolished in 1998 and brought under Income Tax Act in 2004).[8] Thus after the implementation of this code the Income-tax Act, 1961 and the Wealth-tax Act, 1957 will be repealed.[9]
2. It broadens the income tax slabs for individuals, charging 10% for income between Rs. 2,00,000 and Rs. 5,00,000, 20% + Rs. 30,000 for the slab of Rs. 5,00,000 to Rs. 10,00,000, and 30% for income over Rs. 10,00,000.[10]
3. The corporate tax rate is 30% and the effective MAT rate, which is Minimum Alternative Tax. The purpose of MAT is to bring into the tax net "zero tax corporations" that, despite earning considerable book profits and paying beautiful dividends, do not pay income tax due to numerous tax exemptions and incentives offered by the Income-tax Law.[11]

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[8] Yogesh S. Limaye, *Why we need Direct Tax Code,* Taxguru (Jun. 2, 2022) *available at:* https://taxguru.in/income-tax/why-we-need-direct-tax-code-part-i.html (last visited 23 Apr., 2023).

[9] The Direct Tax Code, 2010, S.318.

[10] Manupatra, *The Direct Tax Code Bill 2010- Key highlights* (Aug, 2010), *available at:* http://www.manupatra.com/roundup/314/articles/the%20direct%20taxes%20code%20bill%202010.pdf (last visited Aug. 2022).

[11] Income Tax Department, *MAT and AMT, available at-* https://incometaxindia.gov.in/tutorials/10.mat-and-amt.pdf (last visited Aug., 2022)

4. The foreign companies were imposed with additional tax of 15% as branch profit tax as per clause 111 of Direct Tax code, 2010[12] which was formerly exempt under the Income Tax Act of 1961. Branch Profit Tax is a tax levied on effectively connected profits / income of a foreign entity's branch (or company) in a contracting state (country, in common language) when such earnings are tax authorities to characterize any arrangement as one entered into for tax evasion.
5. The wealth has been increased to 1% on specified assets exceeding Rs. 1,00,00,000 which earlier was on an amount exceeding Rs. 30,00,000.[13][14]
6. The legislation recommends the implementation of GAAR (General Anti-Avoidance Rules), which gives tax authorities the authority to categorize any arrangement as one designed to evade taxes.[15]
7. Proposes to do away with the distinction between male and female income taxpayers for determining exemption limits and it has already been implemented through the Finance Bill 2012. [16]

However, the provided code included defects that prevented it from becoming legislation. Inclusion may increase the compliance burden in two ways. There are no rules that specify when the General Anti-Avoidance Rules shall be applied. In addition, the Bill stipulates that the tax obligation of distinct corporate units must be calculated individually. The Dividend Distribution Tax and the Security Transaction Tax are retained under the bill. Contrary to the notion of progressive taxation of people, these taxes are imposed at a consistent rate regardless of the amount of income or profit. The bill proposes to tax foreign corporations whose "effective management" is located in India at any period of the year. In India, it is uncertain what constitutes efficient management of a foreign corporation.

However, a task force was established in 2017 and will present its report in August 2019, after about two years and more than eighty sessions.

The task team has provided a multitude of ideas to streamline the tax system under the Indian government. Certain of them are, First, simplification of the structure of personal income tax As widely rumoured, the task committee has

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[12] The Direct Tax Code, 2010, S.111.

[13] Manupatra, *The Direct Tax Code Bill 2010- Key highlights* (Aug, 2010) *available at:* http://www.manupatra.com/roundup/314/articles/the%20direct%20taxes%20code%20bill%202010.pdf (last visited Aug. 2022).

[14] The Direct Tax Code, 2010, S.112.

[15] The Direct Tax Code, 2010, S.123.

[16] CBGA India, *Direct Tax Code Bill, 2010, available at-* *https://www.cbgaindia.org/wp-content/uploads/2016/03/Direct-Taxes-Code-DTC-Bill-2010.pdf*

suggested major changes to the personal income tax rates, including the introduction of five slabs as opposed to the present three: Rs 2.5-10 lakh: 10 percent (with a full rebate upto Rs 5 lakh) Rs 10-20 lakh: 20 % Rs 20 lakh-2 crore: 30 percent Rs 2 crore plus: 35 percent In its findings, the task team strongly advocates eliminating surcharges, stating that they should be the exception, not the rule. It also argues that the tax rates should be included in the Income Tax Act, rather than being specified annually in the Finance Act. Tax compliance is based on worldwide trends and best practices, as stated in the second section, Reduced Burden of Tax Compliance. This is anticipated to boost taxpayer clarity and broaden the tax base.

Utilization of Artificial Intelligence (AI) in the tax administration and compliance process. Proposed implementation of collaborative compliance in direct tax administration, which would combine data from banks, financial institutions, and the Goods and Services Tax (GST) network in order to broaden the scope of taxable revenue. Thirdly, amendments to Sections 147 and 148 of the I-T Act granting tax officers the authority to revisit assessment cases based on predetermined criteria. The I.T. officers may examine the assessors' books of account for up to six years in the past. These sections are currently susceptible to interpretation. Assesses contesting the grounds offered by authorities for revisiting cases accounts for forty percent of all litigation. Increasing the minimum case opening threshold: Currently, it is above 1 lakh rupees. In addition, the pre-established criteria for selecting cases for review will be strengthened. Reopening cases must be backed by sound logic. Frequently, cases are reopened after receiving information from banks, financial institutions, or other sources. Assessment processes should be kept anonymous, and the public should have the chance to request clarification from CBDT on tax problems. The government would progressively reduce the corporate tax rate to 25% for all businesses, even those with an annual revenue of exceeding Rs 400 crore. This is the fourth and most significant suggestion. In the past five years, the government has gradually reduced the rate from 30% to 25% for 99.3% of businesses.

However, the 0.7% of major corporations who do not receive this advantage account for about 80% of the total corporate tax revenue and are liable to a maximum 30% tax rate. The proposed corporation tax cut will apply to both major domestic and international firms present in India without a subsidiary that are now taxed at 40%. Foreign corporations pay a higher corporate tax rate, but are exempt from the dividend distribution tax that applies to domestic corporations. In addition, it recommends the elimination of the Dividend Distribution Tax, which is now 20.65%. On the basis of these proposals, the current government wants to complete the writing of the code by 2023 and introduce it at the 2023 budget session.

IV

RELEVANCE OF DIRECT TAX CODE IN INDIA

Implementing the Direct Tax Code in India has a number of advantages. Firstly, The DTC will help simplify the complexity of the tax code, which has around 700 parts and is over 60 years old. It has developed throughout time in response to several revisions. Currently, the entire tax law has taken on a rather chaotic appearance. By bringing all direct taxes under a single code with unified compliance features, a single unified taxpayer reporting system can be facilitated.[17] Second advantage being that considering the current population of India, the taxpayers are around 5.83 crore as per IT Department report on the total ITRs filed till 31st July, 2022 for annual year 22-23.[18]

Considering the size of the Indian population and its demographics, the tax administration must take aggressive measures to bring more individuals into the tax system. When individuals voluntarily pay their taxes, they hold the government accountable for its expenditures. Thirdly, it provides flexibility as the structure of the statute has been developed in a manner which is capable of accommodating the changes in the structure of a growing economy without resorting to frequent amendments. Therefore, to the extent possible, the essential and general principles have been incorporated in the statute and the matters of details are contained in the rules/Schedules.[19] Next, it is created in lucid language, as the number of taxpayers is anticipated to expand dramatically with the expansion of the economy. Therefore, it is vital to keep compliance costs low by encouraging their voluntary compliance. This is sought to be achieved, inter alia, by using simple language in drafting so as to convey, with clarity, the intent, scope and amplitude of the provision of law.[20]

Likewise, the conditions and explanations have been removed since they are unclear to non-specialists. The many embedded conditions in a provision are also nested. Moreover, considering that tax law is fundamentally a business law, substantial use of formulas and tables has been made. Additionally, it will boost Technology Use. Until recently, the taxing procedure in India was entirely physical. The utilisation of modern technologies, social media, and

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[17] Dr. Vikas Singh, *Direct Tax Code: The Metamorphosis,* II HSSR 102-107 (2014).

[18] Income Tax India, *ITR's till 31st July 2022* (Aug. 1, 2022), *available at:* https://incometaxindia.gov.in/Lists/Press%20Releases/Attachments/1088/PressRelease-New-record-of-over-7.24m-ITRs-filed-on-a-single-day-2-8-22.pdf (last visited 1 Aug., 2022).

[19] Dr. Kamal Pant & Ashish Arya, *Assessee perception towards Direct Tax Code (DTC),* II IJMBS (2012).

[20] Dr. Vikas Singh, *Direct Tax Code: The Metamorphosis,* II HSSR 102-107 (2014).

artificial intelligence must now be included into DTC in order to make the process more straightforward and transparent. Recently, the Income Tax department launched a trial programme for the faceless assessment scheme, which entails randomised and anonymized assessment and intends to remove physical interaction between taxpayer and tax assessor. The technique is described in E-assessment Scheme, 2019.[21]

In this approach, there is no requirement to appear before a tax official, and there are no actual transfer of documents or people. It will alleviate a substantial amount of stress and handle problems encountered by tax administration during an evaluation. Additionally, it will lessen the likelihood of lawsuit as in order to avoid ambiguity in the provisions that has invariably given rise to rival interpretations, the Code overcomes even these limitations.[22]The goal is for the tax administrator and the taxpayer to share the same understanding of the law, and for the taxpayer's tax burden to be settled by the assessment. To support this purpose, the Central Government/Board has been granted the authority to avoid lengthy litigation over procedural matters. Lastly, it encourages stability since, under the proposed Code, all tax rates would be established in the First through Fourth Schedules of the Code itself, eliminating the need for an annual Finance Bill. The adjustments in the rates, if any, will be done by suitable revisions to the Schedule placed before Parliament in the form of an Amendment Bill.

V

IMPLICATIONS OF DIRECT TAX CODE ON STAKEHOLDERS

Individuals and businesses, as well as the economy as a whole, are affected by the adoption of the Direct Tax Code. According to recent research on the implementation of the Direct Tax Code, low-income taxpayers would not be significantly affected by the new DTC regulations. As the DTC wants the government to keep the Income Tax Act of 1961's refund[23], middle-income people would not be negatively impacted. Currently, an income of Rs 5 Lakh qualifies for a Rs 12,500 tax credit. It indicates that the taxpayer in this specific category will owe no tax after deducting all applicable expenses. In addition, the cost difference between tax evasion and tax compliance is minimal. People do not join in the tax system out of fear of harassment, but they pay the bill illegally through bribery. Therefore, they may be persuaded easily into tax compliance by simplifying tax rules and making administration taxpayer-

[21] E-assessment Scheme, 2019, S. 6.

[22] Dr. Vikas Singh, *Direct Tax Code: The Metamorphosis,* II HSSR 102-107 (2014).

[23] Income Tax Act, 1961, S.87A.

friendly, and modest Relief will be of assistance. It can be observed clearly that Taxpayers believe that it will help by moderate Relief as believed by 73% while 19% believe that it will not help for moderate relief.[24]

The DTC has recommended lowering the corporate tax rate from 35% (with surcharge) to 25% for firms. This will assist businesses across all industries, but especially those in the FMCG and banking industries, where the effective tax rate is about 35%. This reduction in tax rate will lower the generation of government revenue as a result of which it will become difficult for the government to initiate and/ or continue effectively many developmental programmes for the benefit of the common people.[25]It also recommends a consistent tax rate for both domestic and foreign enterprises, which will facilitate the ease of doing business in India and increase the country's economic activity. India currently ranks 63 as per the Ease of doing business report 2022 among 190 countries which was ranked 62 in 2019.[26]Consequently, the new direct tax legislation presents an opportunity to revamp the whole investment climate in the nation.

The introduction of Direct Tax Code in India may also have an effect on the economy, since the macro component introduced over the last several decades has made our economy more integrated with the rest of the globe in terms of trade and investment. The flow of capital across international borders has expanded dramatically, and tax competitiveness among nations has also intensified. Our tax policy also has an international aspect. As a result, the DTC has the ability to stimulate the whole macrocycle of the economy by expanding the tax base and raising tax revenue, hence enhancing the tax-to-GDP ratio. Also, it is believed by 69% of the population that Direct Tax Code will increase the tax collected by the Government which in return helps in the economic growth of a nation.[27]

VI

CASES LAWS RELATED TO CODE

Over time, the judiciary has also interpreted matters pertaining to taxation, as the collection of taxes and fees is a fundamental method for countries to

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[24] Dr. Taral kumar Pinakinbhai Bhatt, *Effect of New Direct Tax Code (DTC) on Income Tax Act,1961,* VI IJRAR (2019).

[25] Debabrata Mitra, *Direct Tax Code: Effect on Individual and Corporates,* LXIV The Indian Journal of Commerce 20-27 (2011).

[26] WB, *Ease of doing business ranking,* (2019).

[27] Dr. Taral kumar Pinakinbhai Bhatt, *Effect of New Direct Tax Code (DTC) on Income Tax Act,1961,* VI IJRAR (2019).

generate public revenues that enable financing of investments in human capital, infrastructure, and the provision of services to citizens and businesses.[28] In the case of *Kalluri Krishna Pushkar v. Deputy Commissioner of Income Tax*[29],It was determined that anyone who wilfully attempts to evade any tax, penalty, or interest chargeable or imposed under this Act shall, without prejudice to any penalty that may be imposed on him under any other provision of this Act, be punished with rigorous imprisonment for a term that shall not be less than six months, but which may extend to seven years, and with fine.

In a ruling, the Supreme Court emphasised the necessity for a modernised and advanced taxation system. *National Cooperative Development Corporation v. Commissioner of Income Tax, Delhi*[30], Where the Supreme Court has advised the Central Government to evaluate the efficacy of the advance tax ruling system and make it more comprehensive as a mechanism for resolving disputes, rather than litigating them via many layers, whether in the private or public sector.

Some judgments have also been made with respect to the matters of Direct Tax Code. In the case of *M/s Embassy One Developers Private Limited , Bangalore v. Deputy Commissioner of Income Tax Central Circle-2(2), Bangalore*[31] It was stated that The Direct Taxes Code Bill, 2010, seeks to offer a legislative framework for corrective actions to combat the loss of the tax base caused by thin capitalization, since it is believed that India has now awoken to neutralise this type of manoeuvring. As part of the general anti-avoidance rule, section 123(1)(f) of the proposed Direct Taxes Code Bill, 2010 (Bill No. 11 of 2010 as introduced in the Parliament on 30th August, 2010) states: "any arrangement entered into by a person may be declared an impermissible avoidance arrangement, and the consequences of the arrangement under this Code may be determined by recharacterizing any equity into debt or vice versa."

This is the first move India's tax office has taken toward establishing statutory thin capitalization standards. Similarly in *Director of Income Tax v. Copal Research Limited*[32] It was held that after study, the Committee determined that

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[28] World Bank, *Taxes and Government Revenue, available at-* https://www.worldbank.org/en/topic/taxes-and-government-revenue#1 (last visited Aug., 2022).

[29] *Kalluri Krishan Pushkar v. Dy. CIT* (2016) 236 Taxman 27 (AP &T) (HC).

[30] *National Cooperative Development Corporation v. Commissioner of Service Tax,* 2019 S.C.C. OnLine CESTAT 5903.

[31] *Embassy One Developers (P) Ltd. v. CIT*, 2020 S.C.C. OnLine I.T.A.T. 10449.

[32] *Income Tax v. Copal Research Limited,* 2014 SCC OnLine Del 4143.

it was important to provide a precise definition of the aforementioned term, and there was no need to vary from the Direct Tax Code Bill, 2010 (DTC) that had been made public. Under the DTC, profits from the sale of abroad assets that drew more than fifty percent of their value from Indian assets were subject to taxation in India. In addition, it was noted that there is a paradigm shift with respect to the treaty override, as introduced in section 129(9) of the Direct Taxes Code Bill 2010, which states that despite the treaty override provisions in section 129(8), the provisions of the Direct Taxes Code relating to the general anti-avoidance rule under section 123 continue to apply, in the case of Cae Flight Training (India) vs The Deputy Commissioner of Income.[33]

VII

MAJOR STRUCTURAL WEAKNESSES OF DIRECT TAX CODE

Although the Indian government has made a solid start by introducing this innovative piece of law, a number of pressing challenges facing the Indian economy in the area of taxes remain unresolved. The biggest challenge remains black money which is the money that is earned illegally, or on which the necessary tax is not paid.[34] Even if it involves unlawful tactics, tax evasion is a survival strategy in restrictive tax regimes or in situations where legitimate expression of business activity is rendered needlessly onerous by a tangle of laws. Black economy and black money go hand in hand and are also termed as parallel economy, shadow economy, or underground economy.

The biggest challenge before the policy makers is the ever-growing size of the parallel economy in India.[35] According to a report published by Global Financial Integrity in December 2012, India is one of the top ten developing countries in the world with a black money outflow of $1.6 billion (Rs.8,720 crore) in 2010. The total amount of black money outflow was $232 billion, primarily through bribery, corruption, and real estate transactions. The projected total value of illegal assets owned by Indians during the same time frame is $487 billion.[36] The major causes of Black money in India are Government limitations on economic operations; Increase in government

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[33] *CIT v. CAE Flight Training (India) Pvt. Ltd.*, 2019 S.C.C. OnLine I.T.A.T. 12577.

[34] Cambridge Dictionary, *Black money, available at:* https://dictionary.cambridge.org/dictionary/english/black-money (last visited Apr., 2023).

[35] Kulwant Singh, Taxation *Challenges and Direct Tax Code,* LXIV The Indian Journal of Commerce (2011).

[36] Nazaquat Hussain, *Black Money in India: Impact on Indian Economy,* V International Journal of Trade and Commerce 72-78 (2016)

spending and lack of transparency; Political funding; Taxation structure in India. Weak dissuasion against tax avoidance; Low moral standards; Inflation; and the social acceptability of black money, etc. Taxation can lead to black money because high tax rates also increase tax evasion.

Therefore, the need of the hour is to design a tax system of the country in such a fashion which takes these problems into consideration.[37] The outflow of cash from India to tax havens is another crucial issue that Indian policymakers must address. As with the underground economy, there are varying estimates of capital flight from India.

A tax haven is a country in which the taxation of foreigners or foreign companies is exploited on advantageous terms to reduce the tax burden in the actual home country.[38] The word "tax haven" lacks a precise definition. There is no absolute criterion for determining if a nation is a tax shelter. Essentially, any country may be a tax haven provided the conditions are favourable for an individual or business. Such funds are neither contributed to tax haven nor home country taxes, but are claimed as a deduction in jurisdictions that are not tax havens (Congressional Research Service, 2022). Researches advocate that the largest multinational companies across the world contribute to 98 percent of tax haven practices and 40 percent of multinational companies' profits are invested in tax havens causing a global loss of 200 billion USD a year.[39]

Once this enormous quantity of dirty money and property returns to India, the whole foreign debt may be repaid within twenty-four hours. After paying off our total foreign debt, we will have a surplus sum that is over 12 times more than our international debt. If this excess is invested to produce interest, the money earned will exceed the yearly budget of the federal government. The nation can therefore survive even if all taxes are eliminated.[40] Also in addition to this, the population of India currently is 1380 million as estimated in 2021, but only the taxpayers count for the total of ITRs filed till 31st July,

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[37] Kulwant Singh, *Taxation Challenges and Direct Tax Code*, LXIV The Indian Journal of Commerce (2011).

[38] World data, *The most famous tax heavens worldwide, available at-* https://www.worlddata.info/tax-havens.php (last visited Aug., 2022).

[39] World Economic Forum, *Tax havens cost governments $200 billion a year. It's time to change the way global tax works* (Feb. 27, 2020) *available at-* https://www.weforum.org/agenda/2020/02/how-do-corporate-tax-havens-work/ (27 Feb., 2020).

[40] Kulwant Singh, Taxation *Challenges and Direct Tax Code*, LXIV The Indian Journal of Commerce (2011).

2022 for AY 22-23 is about 5.83 crore.[41] Therefore, until this substantial segment is taxed, it is possible that no taxation scheme will provide the intended outcomes. In addition to the tiny number of taxpayers in India, the vast majority of tax filings are grossly underpaid and devalued, which is an issue in its own right. In India, the payment of income tax is not seen as a sacrosanct act, outside of financial and commercial considerations. A person who pays taxes does not have a privileged social position. Rather, an individual who manipulates his tax returns enjoys a higher social standing. This value system is not only backward, but also hazardous to society over time.[42]

VIII

CASE STUDY: TAXATION STRUCTURE IN ESTONIA

Estonia has the best tax code in the Organisation for Economic Co-operation and Development (OECD) for the ninth time as per the International Tax Competitiveness Index released by the Tax Foundation.[43] OECD is an international organisation that works to build better policies for better lives. Our goal is to shape policies that foster prosperity, equality, opportunity and well-being for all.[44] The International Tax Competitiveness Index (ITCI) aims to determine the degree to which a country's tax system complies to two crucial features of tax policy: competitiveness and neutrality. There are several elements unrelated to taxation that influence the economic success of a nation. Nonetheless, taxes play a significant influence in the economic health of a nation. To measure whether a country’s tax system is neutral and competitive, the ITCI looks at more than 40 tax policy variables. These variables measure not only the level of tax rates, but also how taxes are structured. The Index looks at a country’s corporate taxes, individual income taxes, consumption taxes, property taxes, and the treatment of profits earned overseas. The ITCI gives a comprehensive overview of how developed countries’ tax codes

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[41] Income Tax India, *ITR’s till 31st July 2022* (Aug. 1, 2022), *available at-* https://incometaxindia.gov.in/Lists/Press%20Releases/Attachments/1088/PressRelease-New-record-of-over-7.24m-ITRs-filed-on-a-single-day-2-8-22.pdf (last visited 1 Aug., 2022).

[42] Kulwant Singh, Taxation *Challenges and Direct Tax Code,* LXIV The Indian Journal of Commerce (2011).

[43] Tax Foundation, *International Tax Competitiveness Index 2022, available at-* https://taxfoundation.org/publications/international-tax-competitiveness-index/

[44] OECD, *available at:* https://www.oecd.org/about/

compare, explains why certain tax codes stand out as good or bad models for reform, and provides important insight into how to think about tax policy.[45]

In Estonia, an individual who is a resident of Estonia is liable to tax on worldwide income, irrespective of the origin of the income. Non-residents are taxed on their Estonian-source income. Taxable income includes both active income, such as employment and business income, as well as passive income and a flat tax rate of 20%, which applies to all items of income derived by a resident taxpayer. [46] Thus, their it is an obligation on resident to pay taxes as part of income but under India the tax paying is upon the discretion of individuals and neither added as under the list of Fundamental duties under Article 51(A) added by 42nd Constitutional Amendment Act,1976. But the Fundamental Duties were added after the recommendation of Swaran Singh Committee formed in 1976, which included a recommendation that tax payment must be made a duty which is justifiable, but was not accepted by the then government. Thus, India faces a problem of the tax avoidance which is not faced by Estonia as a country.

With a total score of 100 points, Estonia ranks first for Individual Tax and Property rate tax, second for Corporate Rate tax, and fourteenth for Consumption Tax and cross-border tax rules. According to the tax foundation, Estonia's high ranking is due to four beneficial aspects of its tax system.

First, it has a 20 percent tax rate on corporate income that is only applied to distributed profits.[47] The corporate income tax is a tax on the profits of businesses. Corporate earnings taxation in Estonia is truly unique – it shifts the moment of corporate taxation from the moment of earning the profits to the moment of their distribution.[48] This means that generating a profit does not automatically result in income tax liabilities. Only when profits are transferred to shareholders is the tax liability triggered. If the profit allocated to shareholders derives from dividends received from a subsidiary or permanent presence in another nation, there will be no profit distribution tax. A portion of the dividends paid by a corporation with a permanent residence in Estonia are subject to a lower tax rate. A natural person who receives dividends taxed

[45] *Id*.

[46] Worldwide tax summaries, Estonia, *available at-* https://taxsummaries.pwc.com/estonia/individual/taxes-on-personal (last visited Apr., 2023).

[47] Tax Foundation, *International Tax Competitiveness Index 2022, available at-* https://taxfoundation.org/publications/international-tax-competitiveness-index (last visited Feb., 2023).

[48] Work Estonia, *Taxes in Estonia* (Feb. 2022) *available at-* https://www.workinestonia.com/working-in-estonia/taxes/ (last visited Feb., 2022)

at a reduced rate in the hands of an Estonian business or a permanent establishment of a non-resident corporation must pay an additional 7% in income tax. The payer is required to deduct it. A non-resident natural person must pay income tax on dividends received from an Estonian firm in the resident nation as well, and cannot deduct the corporate income tax paid in Estonia by the recipient's resident Estonian company in order to prevent double taxation. Corporate income taxes are the most harmful tax for economic growth, but countries can mitigate those harms with lower corporate tax rates and generous capital allowances.[49]

Second, it has a flat 20 percent tax on individual income that does not apply to personal dividend income.[50] The personal income tax had become the predominant tax by the eve of World War II in many advanced economies, where it now raises approximately 9 percent of gross domestic product. In addition to bringing in revenue, it is progressive—imposing steeper rates on those with a higher income—and reduces inequality measurably.[51] A resident taxpayer in Estonia is subject to a proportionate (i.e. flat) tax rate of 20%, which applies to all sources of income. From 2018 on, a WHT of 7% will be imposed on dividends that were previously subject to a lower rate of 14% at the level of the distributing Estonian firm. Certain pension benefits are subject to a 10% tax. Social insurance programmes such as unemployment insurance, government pension schemes, and health insurance often get a disproportionate share of the money from these levies.

Third, its property tax applies only to the value of land, rather than to the value of real property or capital. Individual and commercial property are subject to property taxes. Numerous property taxes are extremely distorted and add a great deal of difficulty to the lives of taxpayers and businesses. Taxes on wealth restrict the capital accessible to the economy, which harms economic development and innovation over the long run. The yearly land tax in Estonia is computed based on the assessed value of land at rates ranging from 0.1% to 2.5%, depending on the municipality.

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49 Tax Foundation, *Taxes in Estonia, available at-* https://taxfoundation.org/country/estonia/ (last visited Aug., 2023).

50 Tax Foundation, *International Tax Competitiveness Index 2022, available at-* https://taxfoundation.org/publications/international-tax-competitiveness-index/ (last visited Apr., 2022).

51 Dora Benedek, Juan Carlos Benítez, Charles Vellutini, *Personal Income Tax has untapped potential in poorer countries* (Mar. 24, 2022) *available at-* https://www.imf.org/en/Blogs/Articles/2022/03/24/personal-income-tax-has-untapped-potential-in-poorer-countries (last visited Mar. 24, 2022).

Finally, it has a territorial tax system that exempts 100 percent of foreign profits earned by domestic corporations from domestic taxation, with few restrictions. The governments must set the laws that determine whether or how corporate revenue received abroad is taxed. The processes and laws that nations use to these corporate operations are governed by international tax standards. Tax treaties align many tax laws between two countries and attempt to reduce double taxation, particularly by reducing or eliminating withholding taxes between the countries. Countries with a greater number of partners in their tax treaty network have more attractive tax regimes for foreign investment and are more competitive than countries with fewer treaties.

Consequently, it is possible to conclude that a clear advantage of Estonia's tax system is that companies spend less time on tax compliance than they would in any other country in the OECD as it is also among the few countries in the OECD that do not have any property transfer taxes, meaning taxes on the transfer of real property (real estate, land improvements, machinery) from one person or firm to another.[52] Even so, there are some weaknesses to the Estonia tax system including, Estonia has tax treaties with just 61 countries, below the OECD average (74 countries)[53], its territorial tax system is restricted to European nations, and its thin capitalization limits are among the strictest inside the OECD. India can also implement some of the measures adopted by nations such as Estonia, New Zealand, Switzerland, etc. However, because India's demographic characteristics are distinct from those of other countries, comparisons between them are inappropriate. Nevertheless, India can implement some of these measures by adapting them to the Indian taxation system.

IX

WHAT CAN BE EXPECTED FROM THE NEW DIRECT TAX CODE?

The Government of India presented the Budget 2023 with several changes being made to direct Tax regime and was also anticipated to publish a new Direct Tax Code during the budget session of the Financial Year 2023, based on the recommendations of the Task force established in 2017 and which

[52] Invest in Estonia, *Tax Competitiveness Index 2022: Estonia has the world's best tax system* (Oct. 2022) *available at-* https://investinestonia.com/tax-competitiveness/ (last visited Oct., 2022).

[53] Tax Foundation, *Taxes in Estonia, available at-* https://taxfoundation.org/country/estonia/ (last visited Apr., 2022).

delivered its report in 2019, however it was not announced. The important direct tax changes done in Budget 2023 are as follows:

1. Section 87A of the Income-tax Act of 1961 has changed so that people who choose the new tax system can get a rebate on up to Rs 7 lakh more of their total income. This is an increase from Rs 5 lakh. Under the new tax system, if your taxable income is less than Rs 7 lakh, you don't have to pay any income tax.
2. Under the new tax system, the basic exemption limit has gone up from Rs 2.5 lakh to Rs 3 lakh. Under the new income tax system, people who make up to Rs 3 lakh do not have to pay any income tax.
3. The standard deduction is now part of the optional tax regime as well. Salary people who choose the simplified tax regime can get a Rs 50,000 standard deduction. Under the new tax system, pensioners can also choose to take a standard deduction of Rs 15,000.

4. Up to Rs. 3,00,000: Nil

300,000 to Rs. 6,00,000: 5% on income which exceeds Rs 3,00,000

6,00,000 to Rs. 900,000: Rs 15,000 + 10% on income more than Rs 6,00,000

9,00,000 to Rs. 12,00,000: Rs 45,000 + 15% on income more than Rs 9,00,000

12,00,000 to Rs. 1500,000: Rs 90,000 + 20% on income more than Rs 12,00,000

Above Rs. 15,00,000: Rs 150,000 + 30% on income more than Rs 15,00,000

However, some aspects may be anticipated from the New Direct Tax Code for the future implementation of this code based on the need of the moment and recommendations, and they might make DTC a game-changer in the nation's tax reform history. First, it is anticipated that the DTC will be shorter than the Act, which comprises 298 parts, and an effort has been made to streamline the current legislation by removing the complex web of "Provisos" and "Explanations" through the use of clear and concise language. In addition, the quantity of tax revenues has considerably risen over time, forcing the department to consider the compliance costs they suffer. To reduce costs, it is necessary to assist the building of an architecture in which taxpayers support voluntary compliance with the law. This is intended to be accomplished through maintaining the law's simplicity and clarity of meaning. The new DTC is quite straightforward, with fewer sections, and it also replaces a lot of weird portions of the Income Tax Act of 1961.

As start-ups represent the future of economic growth, it is anticipated that a number of incentives would be provided for them, as their promotion through incentives can stimulate the economy. As the "angel tax" has caused unnecessary hardship for taxpayers, a radical change would be to eliminate it entirely. In reality, a number of measures have already been enacted in the 2019 Finance Act and subsequent to its implementation. Thirdly, it is anticipated that the assessment unit for tax processes dealing with individual and corporate taxpayers will be implemented, which would be a significant step toward eliminating the harassment caused by tax officials. All interactions between taxpayers and tax officials will be conducted digitally. Moreover, all digital communication shall bear a unique document identification number. Further, simplification of the tax system can be expected as in DTC under which all tax rates are proposed to be prescribed in schedules[54] which obviates the needs of the finance act of every relevant year.

In addition, any proposed modifications to the rate schedules of a new tax legislation must first be submitted to the legislature as an amendment bill for approval prior to implementation. In addition, it is anticipated that the basic corporation tax rate would be reduced to 25% for both local and international enterprises, which will be a significant decrease for foreign companies in particular. This would draw more international firms and cash to India, so promoting economic growth, but it will not provide a fair playing field for Indian enterprises that are subject to stricter compliance standards.

In addition, the new tax legislation may provide an additional advantageous provision that exempts corporations from paying Dividend Distribution Tax, which is 15% plus 12% surcharge plus 3% cess, and is consequently 20.35%. There is a potential that only shareholders will be taxed on dividends. It may incentivize corporations to issue dividends at a higher rate than historical norms. In addition, it should be simple to update, as the New direct tax code should be drafted in such a way that the statute is expressed by the basic and general principles, to the greatest extent feasible, and the specific matter is contained in the rules/schedules. Moreover, one of the ideas is the adoption of the term 'mediation'.

If adopted, this new notion would be introduced for the first time in Indian law: a taxpayer will be permitted to choose a negotiated settlement before a Collegium of Commissioners after receiving the draught ruling. On both sides, mediators will assist with the discussions. This approach is suggested with the belief that tax litigation would be significantly reduced. With the establishment of this mechanism, it is probable that the Settlement Commission procedure will leave the DTC quietly. The creation of a distinct "Litigation Management Unit" is an additional noteworthy modification. This ~~team will oversee the whole t~~ax litigation procedure, from determining

[54] The Direct Tax Code, 2010, Sch. 1-4.

whether cases warrant an appeal to developing defence tactics. The other major change proposed is that the tax officer who issues the assessment order shall no longer file appeals. The government has taken relatively effective steps over the last year to minimise the volume of litigation. Administrative orders prohibiting the filing of appeals up to a specific tax threshold have been issued, and pending appeals having a tax impact below the prescribed level have been dropped.

X

CONCLUSION

This is an incentive for the Indian government to reinstall the existing Income-tax Law through the DTC, which will replace the five-decade-old Income-tax act, in order to ease the law, the administration of the tax system, to reduce the expense of doing business, bring in foreign resources and capital, and make the system more efficient and user-friendly for taxpayers, with streamlined rules and regulations. This is a chance to revise the Act in accordance with the country's economic requirements and to stay up with the evolution of international best practises. The Code is not an attempt to replace the prevailing Act with any prejudice rather it is an attempt and even an opportunity to revive the legislation.[55] In addition to bringing simplicity, the Code will assure the predictability of duty payments. One of the major tenets of the new legislation was the elimination of all tax evasion and avoidance. The Code restricts as much ambiguity as possible, which was previously resolved at various legislative and governmental levels. Because the Need of the hour is a more comprehensive tax reform in the form of direct tax legislation that encourages foreign investment, promotes corporate confidence, incentivizes honest taxpayers, minimises compliance and administrative burdens, and offers a transparent, stable, and less litigious environment. To promote the increase of the tax base, it is essential that the economy become more compliant with tax laws. Despite the fact that its stated aims are commendable, the DTC's issues are more important. But there are always two aspects of the same situation. The Direct Tax code in India is very much discussed and criticised nowadays. Even though the basic aim behind DTC is simple and helpful to the people, it is very much criticised because many provisions under this proposal may harm the investors and FIIs.[56]

The Direct Tax Code is set to change the whole taxation system of India because the Tax System has failed to prevent tax evasion and halt the expansion of the

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[55] Dr. Vikas Singh, *Direct Tax Code: The Metamorphosis,* II HSSR 102-107 (2014).
[56] Dr. Kamal Pant & Ashish Arya, *Assessee perception towards Direct Tax Code (DTC),* II IJMBS (2012).

parallel economy. In 2012, the Indian government published a white paper on black money stating that the parallel economy is equivalent to India's gross domestic product. One of the pillars of the new legislation is the elimination of all tax evasion and even tax avoidance. As much as possible, the Code restricts ambiguity that was previously resolved at various legislative and governmental levels. Delay in justice is the denial of justice, hence the Code is developing a fast-track settlement. Assessment and Procedures are made free of compulsion and rational. As a result of compiling and consolidating tax incentives, advantages ought to be given in a reasonable manner. The alchemy, the Direct Tax Code of 2013, will be a Golden touch in the realm of Indian Finance.

Lastly, the implementation of the DTC will absorb the time and effort of all parties, including taxpayers, tax officials, tax advisors, and the court. This will need forgetting the current legislation and learning the new code from scratch. The government should pursue this project in an impartial way after consulting with all of the necessary parties. Thus, there are certain provisions which are expected to be incorporated in the New Direct Tax Code proposed to be announced in 2023 as the model tax model should be integrated and connected by administrative reform, economic reform and tax policy reform. Also, it is expected to increase the growth of India as reduction in tax may motivate them to contribute their money in the development of the economy, like establishing business firms, building hotels etc., which play a major role in the growth of the economy. But transformations occur, demonstrating the will of the government at the core must expand its net and respond in response to certain popular requests for refunds and reliefs, to provide incentives for development and fill gaps allowing for evasion and the like. The professionals, the taxpayers and first the subject's students having to deal with these amendments to an already cumbersome Act.