BUDGET 2025: NAVIGATING TAX REFORMS AMID GLOBAL ECONOMIC UNCERTAINTIES

EXPERT VIEW

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As the world economy continues to work through the challenges of weak growth, likely inflation and political actions shifting economic relations, there is continued interest in whether tax policy can make a difference. The new administration is considering extending the tax cuts and Jobs Act in the US while mulling tariffs on products from India and China.

If the US implements these measures, India may find itself at the receiving end as foreign investments and bilateral trade recede to an extent. The sell-off by foreign investors in the Indian equity market is a prologue to what lies ahead.

At the domestic level, there are concerns that the economy may not fare as expected, with a growth target set at 6.6% for the fiscal year 2025. In the past year, corporate investment has not picked up as swiftly as the profits and much of it has to do with the trends in consumption where urban demand remains lacklustre. Yet, the growth in goods and services tax collections is robust and personal income taxes have grown faster than corporate tax collections.

Changing patterns

This reflects the changing patterns of tax incidence. Within this context, there are expectations from Union Budget 2025. There is the usual call for lower income taxes to ease the burden of the rising cost of living and meet the global challenges mentioned earlier while bolstering domestic private investment. However, how probable are rate cuts in the given circumstances?

Experience bears that tax cuts are transitory strategies. The corporate tax cut in 2019 did not kick-start investment in the manner expected. Even though nearly 57% of the incomes reported by corporates switched to the low tax regime without incentives, many of these companies chose instead to build cash reserves and to service debt. Some of this may have to do with the economic impact of covid.

The parliamentary committee estimated that the initial revenue lost due to the tax cut was ₹1.8 trillion, and the benefits corresponding in terms of investment remain unknown. With a focus on improving the tax-to-GDP ratio, the scope for rate cuts remains limited. On the contrary, there is a need for stability of rate regime in the income taxes as much as for indirect taxes.

Simplifying income tax law

Reforms, however, need to continue in different aspects of the tax system. Last year, the government committed to simplifying the Income Tax Act—a long-held vision of many tax luminaries. The budget will be keenly watched for the kinds of simplifications that may be in the offing. The frequently contested sections, complex double negations and labyrinthine references to the tax treatment of specific incomes are expected to receive attention. There is also the long pending agenda for the reform of the international tax system.

India remains committed to the global minimum corporate tax and ensuring the digital economy is taxed appropriately. However, US president Donald Trump's withdrawal from the worldwide tax deal leaves experts wondering whether the status quo may continue or whether India will stay on board with the Organization for Economic Cooperation and Development (OECD). In the budget speech, the finance minister is expected to refer to the rule changes in the offing.

Dispute resolution

Yet another issue the government has repeatedly alluded to is ensuring efficient dispute resolution. Even in 2022-23, the amount of corporate and personal income taxes in dispute was equivalent to half the taxes collected under these heads in that year. While numerous efforts have been made to resolve these, there is a need for speedy and alternative dispute settlement mechanisms.

Although the central government intends to remove tax incentives, certain sectors would remain a priority for India. Manufacturing and the 'green sectors' have been core to India's vision for a while. The unique corporate tax rate of 15% offered to new manufacturing units has been availed by only 0.1% of the corporate taxpayers, which reflects the low uptake. Although the incomes reported under this category have registered a significant rise, it remains to be seen if this has provided the necessary fillip to manufacturing capacity, and whether this benefit needs to be extended.

> It's time to assess if long-term tax policies could effectively support India's net-zero goals

Green energy transition

Further, the need to finance India's energy transition is imperative. There are many estimated gaps in financing. As India has expressed clearly at this year's conference of parties, the role of developed countries has been inadequate, with large-scale funding gaps at the multilateral level.

At the same time, the US and EU have been proactive in setting their tax policy to bolster their transition needs. India is often confronted with the conundrum of attracting large investors in these sectors that desist on the grounds of policy uncertainty, poor ratings or commercial viability of projects.

As tax concessions also exist for certain kinds of investments and investors, it is time to strategically evaluate if there is potential for long-term tax policy to support India's Net Zero priorities.

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