

Significant proposals on direct taxes

A huge number of taxpayers will not be liable to tax. Higher disposable income is expected to boost spending



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The announcements of the Finance Minister in the Budget 2025-26 are expected to bring a lot of cheer for many taxpayers, prominent among them being the individual tax payers. The tax slabs for individual taxpayers have been considerably modified.

Further, the provisions for rebate mean that minimum income at which a taxpayer becomes liable to pay tax has increased from ₹7 lakh to ₹12 lakh. The rationalisation of the tax structure so proposed would have a two clear effects: one, as per the income tax returns filed for AY 2023-24, about 33 million people filed returns with positive tax amounts. Of these 20 million paid less than ₹1.5 lakh in taxes.

A significant part of this segment of taxpayers would now not be liable to tax. In other words, one should expect a significant decline in the number of taxpayers in the economy, in the short run.

Second, the difference in the liability between the old regime and the new



TAX NET. A significant number of assesseees will not be liable to tax

this should aid in the transition from two regimes to one regime. A direction towards simplification in the tax system and a move away from income tax based tax incentives for individuals.

DEMAND STIMULUS

Effects of the above change beyond the tax system are anticipated in the form of a significant stimulus to demand. The expected loss to the exchequer is ₹1 lakh crore suggesting an equivalent stimulus to disposal incomes. Whether these individuals choose to consume or to save and invest remains to be seen.

A note of caution in the direction in which the income tax system is evolving relates to proliferation of rate slabs in

Historically, income tax regimes went through a phase of increasing the number of tax slabs – 11 slabs in 1970-71 Finance Act, where the highest slab was also associated with a very high tax rate of 85 per cent.

The rationalisation and simplification process has meant a systematic reduction in the number of slabs as well as in the peak rate of tax. While the peak of tax remains more modest in comparison – 30 per cent plus a surcharge of 37 per cent, the number of slabs have increased to 10 slabs effectively.

It might be worth exploring whether there is merit and revenue gain from such a structure, since evidently it is more complex and can create some perverse incentives.

NEW TAX CODE

A second significant component of the announcements in direct taxes relate to simplification of the regime. The Finance Minister has announced that a new Income Tax Code will be placed in before Parliament in the next week. The driver for the proposed Code is “It will be simple to understand for taxpayers and tax administration, leading to tax certainty and reduced litigation.”

Aspirations of tax departments to simplify tax legislations often run into

simplification of the law does not necessarily mean a simple tax regime – whether the focus is on simplifying the regime or the language is something to look forward to.

THE CHALLENGES

While language does create challenges in interpretation, perhaps some of the challenges also come from the fact that the tax regime is attempting to address a range of rather complex economic transactions.

The second challenge relates to whether significant changes in the tax language can open up more possibilities for litigation – even simple language would need to be interpreted. The existing jurisprudence may not provide required precedent for interpretation. We look forward to the understanding the nature of change being proposed.

Apart from the proposed Direct Taxes Code, the Finance Minister continues to work on simplification and rationalisation of income tax with a focus on ease of compliance — the proposed changes in the TDS/TCS regimes and proposed simplification in the registration processes for trusts and institutions are measures in this direction.

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