

Actioning trust to generate sustainable revenue

Introduction: At 11.7%, India's tax-to-GDP ratio is significantly lower compared to that of similar sized economies whose ratio is around 25%. We present a few key actionable recommendations to help increase this ratio and widen the tax base.

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Background

India, currently the fastest growing major economy of the world, is the fifth largest economy according to recent International Monetary Fund (IMF) projections.² The Reserve Bank of India has projected a GDP growth rate of 7% for FY 2022–23,³ while the IMF has pegged it at 6.8% in 2022–23.⁴ A sustained high level of growth depends largely on sustainable growth in tax revenue, built around an effective compliance and trust-based tax system. Further, a robust increase in tax revenue can play a pivotal role not only in fulfilling India's ambitious climate stewardship targets but also in achieving the Sustainable Development Goals (SDGs)⁵ set out under the United Nations (UN) agenda for emerging and developing economies. Given these ambitious targets, the need of the hour is to focus on augmenting domestic resource mobilisation.

2 As per the IMF, India increased its lead over the UK in the quarter ending March.

3 https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=54464

4 World Economic Outlook Report, October 2022

5 <https://sdgs.un.org/goals>

Over the past few years, the Central Government has introduced several far-reaching tax reforms. These reforms have contributed to an increase in both tax collections and compliance. However, notwithstanding the tax collections and enhanced compliance by taxpayers, India's tax-to-GDP ratio of 11.7% (in regard to federal taxes, with direct taxes contributing 6.1% and indirect taxes the remaining 5.6%)⁶ is significantly low. In comparison, for similar sized economies (in terms of GDP) such as the United Kingdom, France and Italy,⁷ the tax-to-GDP ratio is much higher at 24.9%, 24.5% and 24.6% respectively. Even South Africa, which is a relatively smaller economy, has a tax-to-GDP ratio of 25%.

Only about 5% of the population files tax returns (about 714 lakh returns were filed during FY 2021–22⁸), with a large proportion of filers declaring income levels that are not subject to tax or that are just marginally taxable. On the GST front, out of 630 lakh enterprises (as per the latest data available from National Sample Survey Organisation 2015-16), only 138.16 lakh have joined the GST network.⁹ It is reasonable to conclude that despite the relatively low per capita income, there is scope for significantly increasing this ratio for India while simultaneously building trust among all stakeholders to help widen and deepen the tax base.

The reasons for non-compliance or less than adequate compliance are diverse and vary significantly across countries with different levels of economic development. Even within a particular country, the factors that influence tax morale (or the intrinsic motivation to pay tax) may have varying degrees of importance for different segments of the taxpayer population. For instance, measures built around a policy of non-intrusive enforcement by leveraging technology may be suitable for encouraging compliance amongst relatively small unorganised businesses, while measures to enhance tax certainty through proactive consultations or faster dispute resolution may be more effective in facilitating compliance by large business enterprises.

A recent World Bank blog titled 'To raise more tax revenue, first build up taxpayers' trust' states that 'substantial evidence across countries and regions indicates that the willingness to pay taxes and support reform is higher when trust in the state is strong.' It adds: 'Citizens are more willing to pay when they know that their money is being well spent on services they want.'¹⁰

Therefore, it is worth exploring trust-building measures for developing an integrated framework to strengthen tax compliance and facilitate tax reform to address the tax gap in India in a sustainable manner.

The normally practised twin approaches of facilitation and enforcement of tax compliance need to be complemented by building a trust-based environment between the taxpayer and the tax administration. Fostering such trust depends on the following factors:

- **fairness:** where taxpayers feel they are being treated fairly
- **equity:** the tax system is perceived to be equitable
- **reciprocity:** the reinforced experience of goodness that citizens associate with payment of taxes
- **accountability:** the assurance provided by measures taken to make the administration accountable.

According to a recent World Bank report titled 'Innovations in tax compliance: Building trust, navigating politics, and tailoring reform,' 'Improvements in trust can thus improve tax morale and contribute to enhanced tax compliances.'¹¹ While a multipronged and long-term strategy would be needed to build such trust, several small but practical and effective steps can be taken in the interim that can be built upon progressively.



6 <https://pib.gov.in/PressReleasePage.aspx?PRID=1814822>

7 Tax revenue (% of GDP), World Bank (<https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS?locations=IN>), 2019

8 https://www.business-standard.com/article/current-affairs/itrs-filed-this-year-even-fewer-than-before-covid-pandemic-shows-data-122080201624_1.html

9 <https://www.cbic.gov.in/resources/htdocs-cbec/gst/Five%20Years%20of%20GST%20-%20GST@5.pdf>

10 <https://blogs.worldbank.org/voices/raise-more-tax-revenue-first-build-taxpayers-trust>

11 Dom, Roel; Custers, Anna; Davenport, Stephen R.; Prichard, Wilson. 2022. Innovations in Tax Compliance: Building Trust, Navigating Politics, and Tailoring Reform. Washington, DC: World Bank. <https://openknowledge.worldbank.org/handle/10986/36946> License: CC BY 3.0 IGO.

The following are some specific measures that could encourage compliance, plug revenue leakages and contribute to building the trust relationship:



1. Widen the tax base

- a. Make the presumptive tax regime more effective
- b. Redesign schemes for small taxpayers under GST



2. Augment revenue

- a. Prune exemptions and incentives
- b. Incentivise last-mile GST payments



3. Manage litigation and enhance tax certainty

- a. Strengthen the dispute resolution scheme for small taxpayers
- b. Introduce mediation as a mechanism to resolve tax disputes
- c. Delink transfer pricing audits and introduce block audits
- d. Improve litigation management under GST
- e. Build a co-operative compliance framework



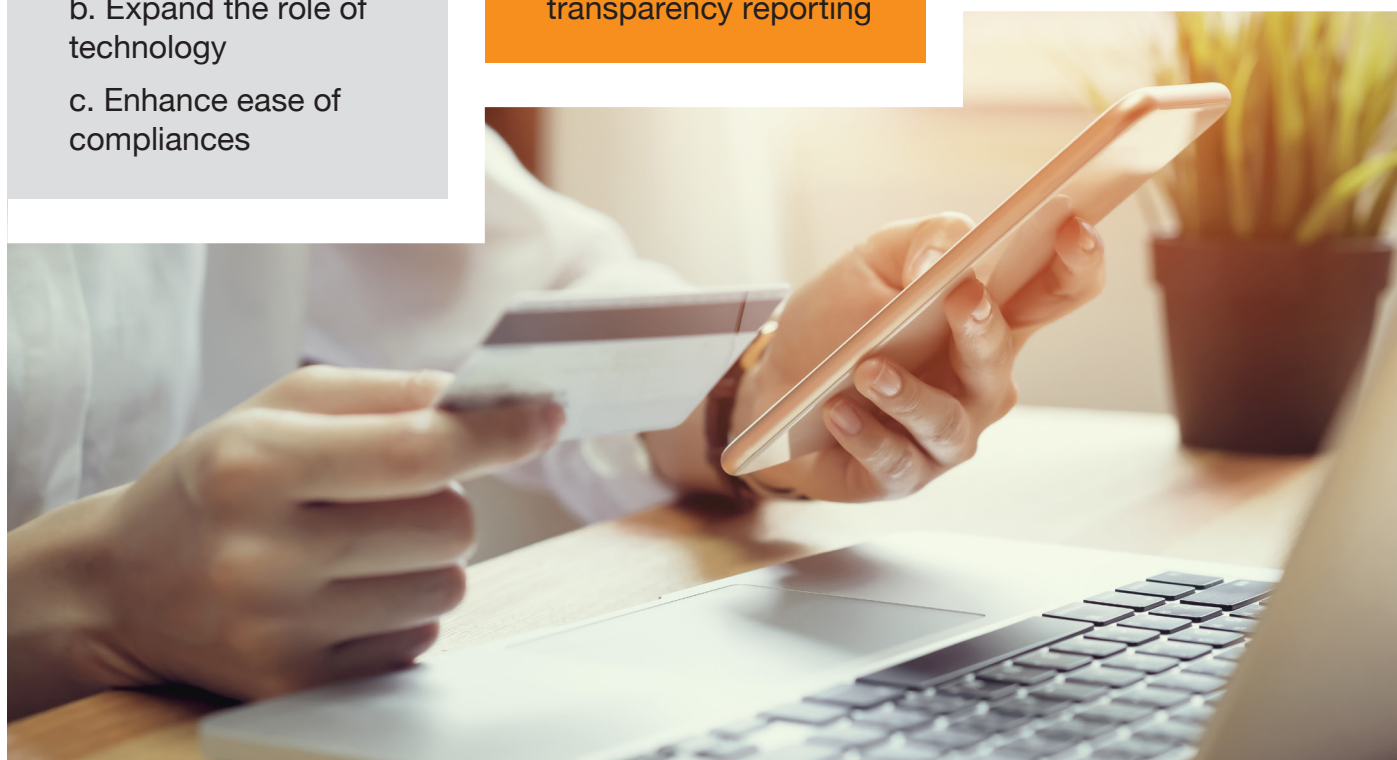
4. Strengthen taxpayer services

- a. Improve communication with taxpayers and build trust
- b. Expand the role of technology
- c. Enhance ease of compliances



5. Align with the ESG agenda

- a. Introduce green taxes and incentives
- b. Introduce a framework for tax transparency reporting



1. Widen the tax base

The unorganised sector indisputably occupies considerable space in India's economy. It is true that many of these firms operate as part of the shadow economy to circumvent the need to pay taxes. Robust efforts should hence be taken by the tax administration to bring these entities into the tax net.

The unorganised sector in India is growing and touching the formal ecosystem more tangibly, especially with the rise of e-commerce and the gig economy. As per a recent NITI Aayog report¹² (India's booming gig and platform economy: Perspectives and recommendations on the future of work, June 2022), the gig economy is expected to increase from the present 80–180 lakh jobs to over 900 lakh jobs in the non-farm sector in the next eight to ten years.

Given the burgeoning size of small businesses, there seems to be a good opportunity to enhance their tax contribution. Under GST itself, while more than 80% of taxpayers belong to the category of proprietorship, their GST contribution is only 13% of the total GST collection.¹³ As per the income tax return statistics published by the Income Tax Department for FY 2017–18, out of 552 lakh individual taxpayers filing tax returns in India, 223 lakh (approximately 40%) paid nil tax.¹⁴ The perceived non-compliance by this sector in turn feeds into impressions of unfairness in the tax system. Thus, specific policy

measures are needed to ensure that the coverage of this sector is maximised and the risk to potential tax base erosion is monitored closely. The following measures could help bring the unorganised sector increasingly within the tax net and address concerns of horizontal inequity in the tax system.

Recommendations

a. Make the presumptive tax regime more effective

A presumptive manner of taxation that lowers compliance costs substantially could incentivise small and medium income earners to develop a culture of tax compliance, thereby broadening the tax base. India already has such a system in place for direct taxes that applies to small businesses with an annual turnover of up to INR 200 lakh, to persons who do not own more than 10 carriages that ply goods and to specified professionals with annual gross receipts up to INR 50 lakh. However, the current presumptive tax regime requires some tweaks to increase its effectiveness and efficiency.

The current presumptive profit rate of 8% of turnover for small businesses could be appropriate for traders but is not ideal for certain categories of service providers e.g., home tutors, event managers and beauty parlour owners who do not require regular commercial outlets or any other significant investment. Consequently, their actual profit margin from rendering such

services is much higher due to low operating costs. The presumptive tax regime can be made more effective by increasing focus on the service sector (other than professional services already covered under the regime) and fixing a higher deemed profit rate for this category of taxpayers.

Further, the current regime provides for a deemed profit rate of 50% of gross receipts for specified professionals like doctors, lawyers and architects. To encourage a greater number of professionals to avail the presumptive tax scheme, this deemed rate of profit could be reduced to account for the perceived fact that these professionals do not tend to make higher profits in the early years of practice. This would incentivise new entrants into the specified professions to make tax compliance a regular part of their lives.

Further, a system may be put in place for obtaining third-party data in the form of an updated register of members, their business addresses, and dates of admission into the profession from their relevant professional association/regulator licensing the profession¹⁵ to enforce compliance by outliers.

Presumptive taxes, if designed well, can help:

- increase compliance by the 'hard-to-tax' group
- address the common concern that the nature of self-employed businesses is not understood by tax administrations

12 https://www.niti.gov.in/sites/default/files/2022-06/25th_June_Final_Report_27062022.pdf

13 https://tutorial.gst.gov.in/offlineutilities/gst_statistics/5YearReport.pdf

14 <https://incometaxindia.gov.in/Documents/Direct%20Tax%20Data/IT-Return-Statistics-Assessment-Year-2018-19.pdf>

15 Journal of Tax Administration, Vol 5: 2 2019, Are Presumptive Taxes a Good Option for Taxing Self-Employed Professionals?

- show that taxing the self-employed is important to ensure voluntary compliance by other taxpayer segments
- address public perceptions regarding horizontal inequity.

Therefore, to ensure voluntary compliance of others, it is necessary to bring a large proportion of the self-employed under the tax net.

b. Redesign schemes for small taxpayers under GST

Under the GST law, a taxpayer with an annual turnover up to INR 150 lakh has the option to register for the composition scheme for supply of goods. Once registered, the dealer pays a fixed percentage of tax on the turnover on a quarterly basis with the requirement of minimal bookkeeping and a single return in a year. Despite this level of simplification, the number of taxpayers under the composition scheme remains very low.

Moreover, as seen in the graph, the number of taxpayers under the composition scheme has reduced over the last four years.

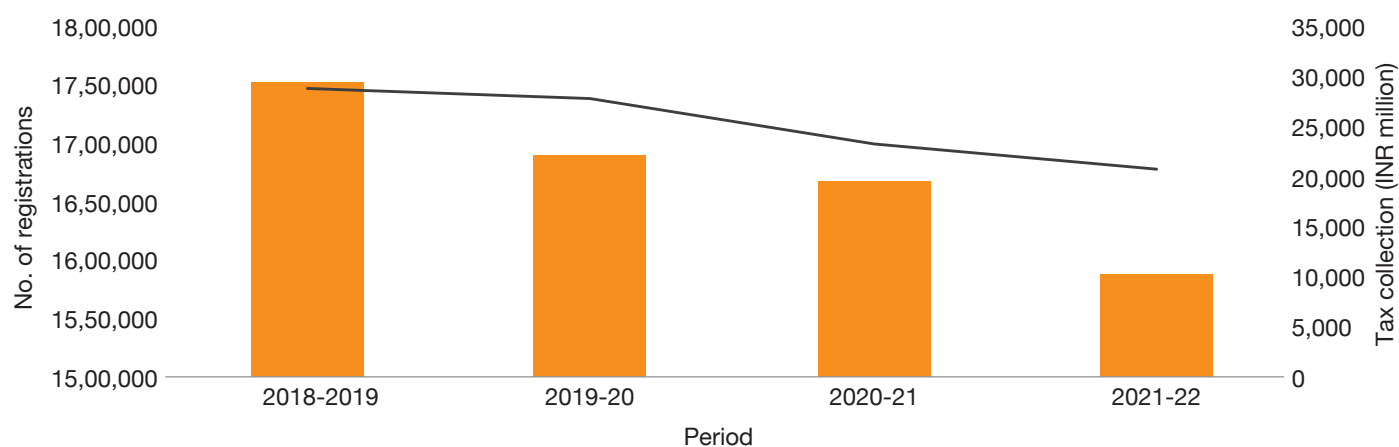
One of the primary reasons for the scheme not drawing more businesses is the limitation in the business territory – that is to say, composition taxpayers are barred from carrying out inter-state transactions. Also, in the past, composition dealers were not permitted to make supplies to e-commerce operators. A welcome step is that pursuant to the 47th GST Council meeting in June 2022, composition dealers have been allowed to make supplies through e-commerce operators. However, these small businesses are still not permitted to undertake inter-state supplies. Freeing them of this territorial constraint would enable a huge number of small businesses to leverage the advantages of the digital economy and to have access to a wider market both domestically as well as globally, especially with

the emergence of India's own platform, Open Network for Digital Commerce (ONDC).

Also, the turnover limit for the composition scheme, which was last revised in 2019, may be revisited and enhanced in line with the turnover limit of presumptive taxation for small businesses under income tax – i.e. INR 200 lakh – so as to broadly align the two schemes. In the service sector, the composition scheme provides a turnover limit of INR 50 lakh per annum with a GST rate of 6%. Given the pace of growth in the service sector in the micro, small and medium enterprises (MSME) category, perhaps this limit for service sector providers could also be revisited and suitably increased.

The compliance burden under GST may be reduced for small taxpayers by redesigning schemes such as the Quarterly Returns Monthly Payment (QRMP) Scheme. Under the QRMP scheme, the registered taxpayer having an aggregate turnover

Composition dealer registration



Source: Goods and Service Tax Network

of up to INR 500 lakh in the previous financial year is required to file quarterly returns instead of monthly returns. However, they are required to make tax payments on a monthly basis.

Taxpayers under this scheme also have an option to report, in lieu of quarterly reporting, invoices using the Invoice Furnishing Facility (IFF) on a monthly basis. This enables them to pass on the input tax credit (ITC) by way of the data flowing from the IFF into their buyers' returns. This monthly filing adds to the compliance burden on small taxpayers.

Once the e-invoicing facility is extended to all transactions, including B2C, an option may be given to QRMP taxpayers to adopt e-invoicing. Using this data, GSTN can auto-populate the recipient's GSTR-2A/2B to enable seamless ITC flow. This will help eliminate the need for filing IFF, which would enhance the ease of doing business for MSMEs. Also, the periodicity of tax returns under this scheme may be revised to annual or half-yearly instead of quarterly so that it reduces the compliance burden to a large extent.

Such redesigned schemes could:

- enhance the ease of doing business
- reduce compliance cost and time for small taxpayers
- enhance voluntary compliance in the MSME sector.

2. Augment revenue

The principal objective of tax policy in a developing market economy is to raise revenue in an equitable manner and with minimal distortions.¹⁶ While the Government has taken steps to augment revenue mobilisation in recent years, the following additional measures can contribute to sustainable revenue growth.

Recommendations

a. Prune exemptions and incentives

Complexity in tax laws is mainly driven by the number of exemptions, incentives and deductions available. A report published in 2015 by the IMF, Organisation for Economic Co-operation and Development (OECD), United Nations (UN) and World Bank, titled 'Options for low income countries – Effective and efficient use of tax incentives for investment'¹⁷ and submitted to the G-20 Development Working Group, found that such incentives tend to complicate the tax system, create horizontal inequity and distort production efficiency. Further, businesses are likely to be seen by tax administrations as using incentives in a way that is contrary to the intent of the legislation, thus contributing to mistrust. A recent study carried out by the OECD indicates that only 59% of tax officials in Asia believe that tax incentives are used as intended.¹⁸

The Indian tax law had traditionally included various tax incentives for businesses, aimed at promoting investment in certain sectors of the economy or in specified backward areas of the country.

In 2016, a bold policy decision was taken to discontinue and phase out almost all profit-linked incentives and instead allow only investment-linked incentives. Subsequently, while some special profit-linked incentives have been introduced to promote investment in housing, support the start-up industry, develop international financial services centres and incentivise purchase of electric vehicles, these incentives have been allowed for limited periods of time. However, the level of tax expenditure is still quite high, when compared with the quantum of taxes collected. As per the Statement of Revenue Impact of Tax Incentives published as part of the Receipt Budget 2022-23¹⁹, the total estimated tax revenue foregone for FY 2020-21 due to various deductions, rebates and special exemptions was INR 1,03,285 crore for corporate taxpayers, INR 8,827 crore for non-corporate taxpayers (firm/association of persons/body of individuals) and INR 1,70,583 crore for individuals/Hindu undivided families.

16 https://www.unescap.org/sites/default/d8files/APSDJ%20Vol.25%20No.1_pp85-107.pdf

17 Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment

18 Para 2.6 of the OECD's Report titled 'Tax Morale II - Building Trust between Tax Administrations and Large Businesses' (September 2022)

19 Receipt Budget 2022-23, Ministry of Finance, Budget Division, 2022

It is therefore necessary that while the currently prevailing scheme of tax incentives that are targeted and time-bound could continue, the focus should narrow over time to incentives for businesses to invest in critical assets and for promoting research, development and innovation. Deductions allowed under personal income tax may be restricted to contributions made towards old-age security, health and education.

Further, the present income tax law still provides for several tax exemptions, many of which have outlived their utility. Tax exemptions that were designed for a specific purpose and are no longer relevant or run contrary to the objective of 'Aatmanirbhar Bharat' should be done away with.

It may also be necessary to revisit the tax exemption on agricultural income given the pressures on Government expenditure, the need to generate additional revenues and in keeping with the principles of equity and fairness in taxation. A monetary threshold-based tax on large farmers in India, as recommended by the Tax Administration Reform Committee (TARC) in its Third Report²⁰ released in November 2014, could be considered in this regard. Such a measure will formally widen the tax base in the country and increase revenues.

On the indirect tax side, currently, the revenue impact on account of various free trade agreements (FTAs) is estimated at INR 68,851 crore (FY22).²¹ With the anticipated

increase in FTAs being signed by India with major developed economies, the potential revenue foregone in concessions in basic customs duty would go up steeply in the years ahead. While the potential revenue loss would be offset with other tax or non-tax advantages offered by the FTAs to some extent, pruning of existing exemptions and concessions in customs still deserves greater attention in such a situation.

At the onset of GST, the revenue-neutral rate was fixed at about 15% with the hope of buoyancy in revenue. However, with many concessions and rate-slashing over the initial years, the current average rate hovers at around 11.5%. While GST collections have been stable at over INR 1,40,000 crore per month²² since the last eight months, several policy measures would be needed to make it more buoyant. Aligned with the principles of equity in taxation, one crucial step would be the reduction of the numerous exemptions for both goods and services, which drain the exchequer while adding to the input costs in the value chain due to non-availability of input tax credit (ITC).

As in the case of customs, a fixed shelf life may be specified for the exemption notifications in GST so that they do not outlive their initial objectives. Of course, the discretion to extend them in case of any exigency should still be available.

In parallel, there is also a need to expand the current base of GST by bringing within its ambit the large sectors of the economy such as petroleum and electricity. NITI Aayog has also stressed that given a seamless ITC mechanism under GST, the industries in this sector could see a rise in post-tax profitability. This would also enhance the direct tax receipts of the Government.²³

b. Incentivise last-mile GST payments

The last-mile GST issues on non-compliance at the B2C level are a matter of concern for all tax administrations, as they lead to tax evasion. One scheme often adopted to counter this is the VAT/GST lottery. Such a scheme was first introduced by Taiwan in the 1950s. Many other countries introduced various types of prizes including cash prizes (the Philippines) and in-kind prizes like cars (Poland) and the chance of appearing on a television show (Slovakia).²⁴

The Kerala state government recently introduced the Lucky Bill App²⁵ under the GST regime which encourages consumers to upload GST invoices by giving them prizes such as vouchers for stay in Kerala State Tourism Development Corporation hotels. The data from such apps can be leveraged to detect evasion of GST in the last mile. Schemes such as these, if introduced across the country, can incentivise vigilant consumers to ask for a GST bill, while acting as a deterrent to potential tax evaders.

20 Third Report of TARC

21 Annex 7 of the Receipt Budget 2022-23

22 <https://pib.gov.in/PressReleasePage.aspx?PRID=1872591>

23 <https://www.financialexpress.com/economy/fuels-electricity-under-gst-ambit-niti-aayog-formula-includes-six-year-aid-to-states/2315522/>

24 International Growth Centre

25 <https://keralataxes.gov.in/2022/08/01/lucky-bill/>

3. Manage litigation and enhance tax certainty

One of the essential components of strengthening trust is improving the predictability and certainty of tax enforcement.²⁶ Uncertainty in tax can arise in different areas of the tax system, dispute resolution being a prominent area of concern for taxpayers. While tax disputes are perhaps an inevitable part of any tax system, there is a need for them to be resolved effectively to minimise related costs and inefficiencies as also to timely realise revenues that are blocked by litigation. The following steps could increase administrative efficiency, help with litigation management and thereby increase tax certainty.

Recommendations

a. Strengthen the dispute resolution scheme for small taxpayers

The finance ministry's Annual Report for 2017–18,²⁷ which featured historical data on appeals pending before the Commissioner of Income Tax (Appeals) (CIT [Appeals]), indicated that 66% of these pending appeals were related to small tax disputes (tax demand of less than INR 10 lakh).

While pending disputes are being resolved or adjudicated, it is necessary to ensure that in future fewer disputes arise from fresh assessments. To facilitate this, the Government has introduced a

new alternative dispute resolution scheme for small and medium taxpayers in the form of a Dispute Resolution Committee (DRC). The intention of the scheme is to provide early tax certainty to small and medium taxpayers having taxable income of up to INR 50 lakh and disputed income of up to INR 10 lakh, by preventing new disputes and settling any issues at the initial stages.

Eventually, it is recommended that the scheme be expanded to also cover larger taxpayers. Considering the scheme is faceless and anonymised, it will usher in an entirely new ethos that permanently alters the relationship between the taxpayer and tax department, building trust.



26 Dom, Roel; Custers, Anna; Davenport, Stephen R.; Prichard, Wilson. 2022. Innovations in Tax Compliance : Building Trust, Navigating Politics, and Tailoring Reform. Washington, DC: World Bank. © World Bank. <https://openknowledge.worldbank.org/handle/10986/36946> License: CC BY 3.0 IGO.

27 Annual Report 2017–18

b. Introduce mediation as a mechanism to resolve tax disputes

Considering the high level of tax litigation in India and staggering pendency of cases in various appellate forums, a growing view is that there needs to be some sort of a mediation mechanism to resolve tax disputes –before such issues even arise. The essence of the mediation mechanism is to involve a third party (mediator) – an independent expert who helps the parties to develop a certain agreement on the dispute – while the parties fully control the decision-making process on the settlement of the dispute and conditions for its resolution.²⁸

Mediation of tax disputes is already being practiced in various countries. Jurisdictions like the US, the UK, the Netherlands and Belgium have adopted mediation as a viable alternative dispute resolution mechanism for tax disputes. In fact, even the Indian Supreme Court, in a recent judgment,²⁹ has impressed upon the Parliament to enact a separate Indian Mediation Act that can comprehensively deal with civil disputes. Pursuant to this, a Draft Mediation Bill, 2021,³⁰ was placed before the Rajya Sabha in December 2021, proposing that civil or commercial disputes be settled through mediation before approaching any court/tribunal. While the Draft Mediation Bill 2021 seeks to exclude tax disputes, the Government could consider carving out an exception and introducing a separate mediation process to resolve tax disputes by codifying a mediation framework within the tax law itself.

The proposed scheme of mediation could be implemented by the constitution of a mediation panel that is empowered (in the same way as the existing DRC) to resolve tax disputes, along with the constitution of an expert panel of mediators that may comprise of retired tribunal members/IRS officers, experienced chartered accountants and lawyers. The

scheme would be optional, and would allow the taxpayer to withdraw at any time to pursue regular appellate channels. In the first instance, such a scheme could be introduced for resolving transfer pricing (TP) disputes. Later, with the help of experience gained, it could be extended to other categories of disputes.



28 Alternative Procedures for Settling Disputes – Lana L. Arzumanova [Financial Law Review No 23 (3)/ 2021

29 M.R. Krishnamurthy vs New India Assurance Company [2019 SCC online SC 315]

30 <https://legalaffairs.gov.in/actsrulespolicies/mediation-bill-2021>

c. Delink TP audits and introduce block audits

The TP litigation environment in India has evolved over the years. Since the introduction of the TP regime in 2001, TP adjustments have increased significantly year on year, touching a peak of INR 70,000 crore in FY 2013–14.³¹ While the quantum of TP adjustments may have reduced since FY 2013–14, India continues to remain among the most litigious TP regimes in the world. Further, a majority of the appeals (72%) on TP matters filed before the tribunals are by taxpayers and have a high success rate, with 82% of the taxpayers' appeals being allowed or partly allowed in their favour. On the other hand, 61% of the tax department's appeals have been dismissed.

Internationally, TP audits are generally independent proceedings that are handled by expert TP teams. Cases are selected for audit based on identified high-risk parameters. Moreover, once a case is selected for a TP audit, the relevant transactions or arrangements are examined for many years in one go.

To resolve the issues mentioned above and better align TP practices in India with those followed globally, TP audits should be delinked from regular assessment proceedings. Accordingly, TP would be an entirely different vertical, having its own system of risk-based case selection for audit, an audit process that is entirely independent of the regular assessment proceedings, and a separate and parallel appellate channel.

Further, the existing dispute resolution panel should be replaced with a mediation panel (mentioned above) which will deal solely with TP issues. The amicable settlement of TP disputes via mediation will:

- significantly reduce protracted TP litigation
- promote a relationship of trust with the tax department
- positively influence India's Ease of Doing Business index.

Further, in line with the global best practices followed by many developed countries such as the US, Germany, Australia and many other European countries, block audits covering a period of three to five years should be considered for TP cases.

d. Improve litigation management under GST

Although GST in India has completed five years, the proposed GST Appellate Tribunal envisaged to render prompt and effective remedy to aggrieved taxpayers is yet to be established. Meanwhile, appeals to be taken up by this appellate forum are mounting across India. Even as the tribunal is being launched, the huge backlog of cases could virtually choke the system, enormously delaying current and future appeals. As a result of huge delays in delivering verdicts, taxpayers may become distrustful towards the appellate machinery. Hence, proactive steps must be taken to ensure that the appellate system is well-equipped to accommodate the considerable volume of appeals in the future.

In order to reduce the backlog, a potential way out is to provide a tailored amnesty scheme for those who wish to pay a fixed portion of the disputed tax amount under litigation, but can still be eligible to claim credit for the tax so paid. Also, a monetary threshold limit may be fixed for GST cases, below which no litigation would be initiated by the tax department in appellate forums such as the Commissioner (Appeals)/tribunals or high courts or the Supreme Court. Further, given the success of online hearings in the post-pandemic era, virtual hearings may also be permitted under law for proceedings in the proposed GST Appellate Tribunal.

e. Build a framework of co-operative compliance

The rising number of tax disputes, high-pitched assessments and indiscriminate penalties have cost the tax administration dearly in terms of taxpayer trust. At the same time, a much greater level of uncertainty has been imposed on taxpayers through a slew of anti-avoidance and compliance measures including, but not limited to, general anti-avoidance rules in domestic legislation as well as in tax treaties. In order to change the taxpayer's perception towards the tax department and impart greater tax certainty (particularly to large investors), a more comprehensive and holistic approach to compliance is needed in India. This approach can be built around the co-operative compliance model that is being explored and implemented in several parts of the world.

31 Transfer pricing disputes trends (2015)

Co-operative compliance is an expansion of the risk-based approach to tax compliance. It envisages ongoing and real-time cooperation between taxpayers and the tax authorities, which would result in the payment of correct taxes on time – in an effective and efficient manner. The model is based on the premise that the taxpayer can be trusted and the tax administration acts predictably, thereby providing tax certainty. Operationally, the underlying assumption is that if the taxpayer is transparent and able to demonstrate how she/he is making bona fide efforts to fulfil her/his tax obligations, the tax administration will not only guide the taxpayer on the manner of compliance expected but will also provide certainty in advance regarding a tax position. The tax administration expects taxpayers to give them access to their control systems used to manage tax risks. If satisfied with the control systems, the tax administration adopts a light-touch compliance regime to the eligible taxpayers. This can potentially lead to the speeding up of assessment processes and thus faster resolution of uncertain positions. At the least, it would lead to an enhanced relationship with the largest taxpayers based on mutual trust and understanding, real-time information and more efficient use of resources.

The OECD's 2013 report on the Co-operative Compliance Framework (CCF)³² – based on surveys from 21 member countries of the Forum on Tax Administrations and consultations

with business – concluded that the CCF can become an important tool for building tax certainty and driving trust-based voluntary compliance. The OECD termed this concept as 'transparency in exchange for certainty'. The OECD also published another report on the subject in 2016,³³ providing guidance for businesses on the design and operation of tax control frameworks (TCF) and tax administration on adjustment of their risk management strategies for large enterprises under co-operative compliance.

Many countries have implemented or piloted the co-operative compliance model. To some extent, the Indian Government has been quite active in adopting measures that can fall within the ambit of co-operative compliance. To further augment the CCF, which is in consonance with the objectives of fostering voluntary compliance by reposing trust in the taxpayer, a high-level committee may be tasked with examining the co-operative compliance models being run in different countries and developing a CCF that is feasible and in tune with the current needs of the Indian tax system. The model can be formalised by publishing explicit frameworks explaining how the arrangement would work and individual agreements between taxpayers and tax administrations that specify the expectations and outcomes. Since these frameworks would require taxpayers to establish internal control systems that can effectively identify and manage

tax risks, a CCF would typically be open to the largest taxpayers, on a purely voluntary basis. The model eventually implemented could cater to compliance – under both direct as well as indirect tax laws.

On a similar note, a risk-based, targeted audit in GST would help the tax administration to adopt the least-intrusive strategy, engender trust and foster voluntary compliance. Further, when risk-based approaches are in place, businesses are likely to improve their internal controls to manage tax risks. Thus, it would be appropriate for GST administrations – especially at the state level – to uniformly adopt data-driven risk-based audit methods in their journey towards building a CCF.

4. Strengthen taxpayer services

Tax administrations have a key role to play for reciprocity and accountability in taxation, as this is an important factor in shaping compliance attitudes. The system of reminding taxpayers through SMSs regarding the dates for payment of taxes and filing returns is functioning well. Additionally, a mobile app has been developed that can provide information to the taxpayer on the status of his/her various tax matters, and this app has been downloaded in large numbers. The holding of return-filing camps and income-tax stalls at public exhibitions has been widely welcomed. Apart from these initiatives, the following measures can increase customer

32 OECD's Report on "Cooperative compliance: A Framework – From Enhanced Relationship to Cooperative Compliance," (2013)

33 OECD's Report on 'Co-operative Tax Compliance – Building Better Tax Control Frameworks (2016)

experience of taxpayers and promote increased trust in the tax system, thereby contributing to increased compliance.

Recommendations

a. Improve communication with taxpayers and build trust

The Indian tax administration has been active in implementing some measures for building bridges of trust between taxpayers and the tax administration.

The use of technology has helped it to address several challenges related to complexities, ambiguities and inconsistencies in the filing and processing of tax returns. In addition to the efforts being made, the tax department could strengthen the taxpayer services vertical through measures based on behavioural principles. These could include:

- enhancing communication with taxpayers
- creating tax awareness through education or workshops
- building a customer management platform to manage taxpayer relationships right from registration to the introduction of a taxpayer-facing virtual agent on the income tax portal could be implemented through a bot framework.

These measures may be complemented by devising innovative ways of rewarding good taxpayer behaviour. In the field of income taxation, while issuing of certificates of appreciation is a welcome initiative, such certificates could be accompanied by more tangible benefits like reward points that can be redeemed to fast-track public services.

Further, while the Government has established a Taxpayers' Charter and given it statutory recognition under the Income-tax Act, currently there is no system of tracking whether the tax administration has adhered to the commitments made in the charter. To fix this, the Government could consider publishing an annual report highlighting the performance in respect of various commitments made in the charter, along with some qualitative analysis. For example, the Inspector-General of Taxation, Australia, conducted a detailed review into the Taxpayer's Charter and taxpayer protection to examine its effectiveness and recommend areas of improvement.³⁴

Additionally, at present, there are no provisions in law that can compensate the taxpayer for unwarranted delays in actions, such as the disposal of applications for rectification and giving effect to appellate orders. The ability to refer long-pending grievances to the Tax Ombudsman, who are independent of the tax administration and are suitably empowered to assign positive or negative points to tax officials based on their effectiveness in

resolving the grievances, can be very helpful in this regard.

Other areas that may be revisited to signal the Government's intention of moving from an enforcement-based to a trust-based tax system include:

1. redesigning penalty provisions on the fundamental premise that penalty is a correctional mechanism for defaults and not an important source of revenue
2. adopting a balanced approach towards prosecution by restricting it to extenuating circumstances and severe defaults
3. avoiding retrospective legislative changes that could have a negative impact on taxpayers
4. redesigning GST provisions to categorically avoid simultaneous assessments or investigations under dual jurisdictions, often involving both the Central and some state GST tax authorities
5. introducing a more formalised system of issuing public rulings on select legal issues as well as guidelines specifying the compliance behaviour expected in respect of newly enacted laws and complex legal processes.



34 <https://cdn.tspace.gov.au/uploads/sites/64/2016/12/Review-into-the-Taxapayers-Charter-and-Taxpayer-Protections.pdf>



b. Expand the role of technology

Technology is the key to enhancing taxpayer facilitation as well as compliance. Substantial progress has been made in this regard, both in the direct as well as indirect tax systems. Under GST, the Government has successfully implemented measures such as e-invoice and e-way bill to capture live transactions. In future, an e-invoicing requirement may be extended to even B2C transactions in order to address the last-mile problem of inadequate compliance. Countries such as Australia have promoted the inclusion of smaller taxpayers in the GST system by way of financial support to lower their compliance costs. In the Indian context as well, the Government may evaluate providing technology support to the MSME sector, enabling it to undertake corporate tax (including withholding tax) and GST compliances.

As tax analytical tools are implemented for data collection, data forecasting, effective management of assessments/appeals and behavioural trends, it is likely that artificial intelligence (AI) will be a vital part of the tax function in the future.

It is worth adopting newer approaches such as design thinking and user experience to simplify complicated rules and procedures and provide a better taxpayer experience. Further, the Government may explore blockchain technology for e-invoicing, e-registration, e-payments, e-filing, e-assessment and e-audit. Countries like China are already using blockchain to detect fake VAT invoicing.

c. Enhance ease of compliances

Enhancing the ease in tax compliances will build trust among the taxpayers and also broaden the tax base. This will

also promote the culture of compliance and ensure stability in tax structure. Following are some of the measures that may be explored by the Government in this area:

i. Measures to address working capital issues

Under the GST regime, ITC balances (viz. CGST, SGST and IGST) are required to be maintained at state level. Therefore, companies having GST registrations in multiple states are not allowed to adjust the ITC balance of one state with the GST liability of other states, resulting in an additional burden on cash liquidity. The Government may consider at least allowing the CGST and IGST credit balances to be maintained at a national level so as to allow cross-utilisation of ITC balances between units having the same PAN, similar to recently introduced inter-state transfer of cash balances.

In addition to the above, the Government may also consider introducing a well-integrated model for cross-utilisation of direct and indirect taxes at the Central level. For instance, one possible measure could be adjustment of excess GST paid or ITC against the liability of income tax or basic custom duty. This would help taxpayers to optimise their working capital.

ii. Group registration under GST

In India, GST registration is mandatory in each state of operation, which has resulted in multiple return filings, huge cash flow impact and

higher compliance burden for businesses that have pan-India presence. Ever since the introduction of GST, the industry has been seeking ways to ease this regulatory compliance burden. A few countries like Australia allow large businesses to take a group GST registration. The Government may consider exploring such a facility in India, which will help businesses having pan-India entities. Such entities could be permitted under law to submit a common GST return, resulting in lower compliance costs and improved cash flows.

iii. Aligning valuations under TP and customs

Often, it is seen that while there is data sharing between the TP and customs authorities, the stand taken by either of these authorities could adversely affect the taxpayer under the same factual circumstances. The Government may consider implementing a collaborative administrative framework for TP and customs with respect to the import of goods from related parties. Such robust collaboration has been functioning in many countries such as South Korea, where along with the advance pricing agreement (APA), there is a consultative facility of Advanced Customs Valuation Arrangement (ACVA) to help the taxpayer arrive at a valuation which can be mutually accepted by the tax as well as customs authorities.

5. Align with the environmental, social and governance (ESG) agenda

India has committed to achieving net zero emission status by 2070, in addition to several other ambitious objectives to be fulfilled by 2030. Organisations need to reassess their businesses with due consideration of the ESG factors and engage in activities that will help in achieving the ESG objectives of the country. This enhanced activity to address environmental concerns requires substantial funding and policy support from the Government. Moreover, such initiatives simultaneously present new business opportunities that demand changes in the existing business models. Some measures to move the needle towards the green zone are as follows:

Recommendations

a. Introduce green taxes and incentives

Tax policies that factor in the unprecedented changes witnessed could be used as a lever to propel the ESG agenda. Several countries are opting for the introduction of coordinated measures comprising green taxes as well as incentives (carrot and stick approach). The implementation of 'green taxes' and related 'incentives' would be an important part of the efforts being made towards achieving the climate goals that India has set for itself.

b. Introduce a framework for tax transparency reporting

Tax transparency reports filed voluntarily by businesses, together with concerted efforts by the tax administration to show how taxes paid by citizens are being

used to promote the welfare and development of people, would go a long way in enhancing the element of trust and pride in paying tax.

A well-designed non-onerous tax transparency framework on tax metrics, such as effective tax rate (ETR) and tax management practices that are voluntary for reporting by businesses, would create more awareness about the tax behaviour of organisations and also provide indicative inputs to regulatory bodies. The continuous review of voluntary disclosures would also help in building trust in respect of tax behaviour of businesses. In addition, a comparative assessment of the peer group could prompt outliers to explain their positions in their voluntary disclosures.

The Government can consider introducing a tax transparency framework on a voluntary basis in line with the Global Reporting Initiative (GRI) 207 tax standard for businesses having a material presence in India. These businesses can set a precedent by reporting relevant information in a consistent and uniform manner for better comparability, transparency, trust and relationships with stakeholders.

Using technology the Government could disseminate to the individual taxpayer targeted information on good work being done in the area where such a taxpayer live. For example, if a road is being built passing through the city of a taxpayer, it would be good to share the progress on that project with them at a reasonable frequency in order to reinforce the association of payment of taxes with the experience of tangible benefits.

The road to collective progress

India is currently on the road to becoming a developed economy, operating on the foundations of a just and fair socioeconomic order. The country's progress can be sped up by building bridges of trust between the Government and the people. The underlying recommendations in the areas of widening the tax base, augmenting revenue, effective litigation management and increasing tax certainty, strengthening taxpayer services and aligning with the ESG agenda can contribute significantly to the Government's continued focus on building trust between taxpayers and the tax administration.

While some of the initiatives such as effective litigation management and strengthening taxpayer services may be prioritised, measures to widen the tax base, augment revenue and align with the ESG agenda can remain an ongoing process that could be initiated and implemented in a phased manner.

These measures, in turn, will encourage voluntary compliance, leading to sustainable growth in tax revenue and achievement of the SDGs that India has set for itself. As industry bodies, intermediaries and corporates play a constructive role in this journey, the approach would be in consonance with the overarching theme of the Government: 'sabka saath, sabka vikas, sabka vishwas, sabka prayaas' (with everyone, for everyone's progress, winning everyone's trust, with everyone's efforts).

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