

# Governance of Tax System and its impact on capital markets



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## Governance – changing focus

“Governance” is the key focus of Governments and regulators alike be it corporates regulated by Ministry of Corporate Affairs/Securities Exchange Board of India or Banks and financial institutions regulated by Reserve Bank of India or Insurance companies regulated by Insurance Regulatory and Development Authority. Or, the assurance

providers like statutory auditors by National Financial Reporting Authority/Institute of Chartered Accountants of India. The list is ever expanding.

The objective of this enhanced focus and stricter actions in case of non-adherence to the standards of Governance set out by the authorities is to ensure high standards of efficiency and effectiveness in operations, transparency and accountability in decision making leading to protection and augmentation of interests of stakeholders at large.

And, is that also not the objective of the Government's tax system; taxation policy and its implementation whether it relates to levy and collection of taxes or the mechanism for collection of taxes, redressal system for grievances and so on such that there is greater transparency and accountability?

To say that a stable tax regime enhances investor confidence and plays a key role in attracting new investment and economic activity enriching the nation and citizens is to state the obvious and that is always the stated objective of taxation policy of governments. And, the capital markets reflect the result of ability of the Government to achieve it or otherwise.

This message was well articulated by the Chairman of Central Board of Direct Taxes<sup>1</sup> when he assumed charge in July, 2024 in his communication to the officers and staff of the Income tax Department when he stated that the *“Decisions that we take have implications on nation's economy and ease of doing business including international transactions and businesses”*.

One must recognise that the tax payers, in general, like to pay their due share of taxes and what they expect in return is better, sympathetic and fair regime whether it is policy or its implementation. Just as tax payer enrichment at the cost of exchequer is not acceptable, should it not be for the exchequer also?

We have come a long way since independence with economy, working population and tax kitty of Government(s) growing many fold. As we are now preparing ourselves to move into the next era of growth and development, moving up in the chain from developing economy to a developed economy, I believe it is time to set

out a clearly defined “Tax System Governance Code”.

## Tax System Governance Code – Policy Statement

The Code ought to have a well-defined Taxation Policy Statement and similarly, clearly stated mechanism to achieve what it has set out to achieve. While undertaking this exercise, one must continuously remind one's self and test/challenge each aspect of the policy and implementation mechanism from the prism of transparency, fairness, accountability and competitiveness of industries and overall economic development of the country.

We do find articulation of Income tax Department's “Vision, Mission and Values” in the document titled “Vision 2020: Strategic Plan 2011-15”<sup>2</sup> and notes that the Tax Department has not lost sight of the fundamental principles of taxation system which refers to taxation policy that is progressive, administration that is efficient and effective such that it leads to improvement in voluntary compliance by making compliances easy, fairness in enforcement, delivery of quality services and continuous upgradation of skills and motivated workforce in tax department. Alas, if wishes were horses!

Tax System Governance Code would require Government(s) to set out taxation policy clearly detailing principles to be adopted in formulation of taxation policy, how it will be changed, what will be considered for its change, prospectivity vs retrospectivity, how and what would trigger such changes, how much time will be given for implementation of new or changed policy and so on.

Any change in any part of the tax system whether it is rate, classification, computation, additional taxes like cess and so on requires change in computerised processes/software and in the current widely digitally interconnected world, it has significant impact on several units/entities across nations and takes time for corporates and government systems alike to implement the changes. It also entails significant costs, financial and human resources.

Is it not the time for Government to state in the Taxation Code that every proposal for change in tax law will be required to be accompanied by the estimate of revenue recovery and estimate of cost of compliance for tax payers and tax department including changes required in software, training of staff, changes in systems and processes, etc. This will provide basis on which Parliament will be able to take well informed decision. This means that effectively, if cost of compliance is significant in comparison to the revenue gain, the proposal may not be approved/passed by Parliament.

Another critical aspect that we need to consider is: should the proposals for changes in Tax Laws be announced with the Budget or should these announcements be by separate mechanism; delinked it from the Budget exercise.

Tax System Governance Code in terms of policy statement also ought to set out time frame for making proposals for changes in law, time for consultations (receiving feedback/comments from stakeholders), publication of gist of such responses, view of the

Government( accepting the recommendation/comments or rejecting them with rationale of the tax department) and the final decision which is enacted into law.

There must be at least 12 months' time for the change to take effect to enable taxpayers to organise their affairs/ systems and processes. The perception that the tax payers will arrange their affairs in such a manner that they will not have to pay tax or pay reduced tax and therefore, amendments must be made effective immediately, from the date of announcement, is the perception/mind-set that must be changed. It must be recognised that the tax policy is for long term and in long term, the impact will be evened out.

There is also a supervisory mechanism in place in form of audit by Controller and Auditor General of India. A review of these reports would indicate that the focus of these audits is at the implementation/application level and that too primarily on the short fall in collection/views taken by a specific officer and so on. This is also not encouraging from a taxpayer's perspective. The role of such audits could be enhanced to include the manner in which policy is implemented and whether the policy itself or implementation mechanism needs to be revisited.

When it comes to implementation mechanism from the perspective of tax payers, we find that there is a Taxpayer Charter issued by the Tax Department , effective from 13 August, 2020<sup>3</sup> for income tax which states the objective of the Taxpayer Charter as:

*"Taxpayers Charter is for building trust between the taxpayer and the income tax department. The Taxpayers Charter defines a taxpayer's rights and obligations under the law. It also specifies the department's commitment to providing services to the taxpayers. The Charter is a step in bringing in transparency in the tax services from the department and tax compliance by a taxpayer."*

The current Charter is at the level of rights and obligations under the law. Do we need to go beyond that and start from the Taxation Policy itself; its formulation, as stated in Vision 2020 document of the Income tax Department ? Take for example, very recent proposed amendment in the Finance Bill, 2024 relating to taxation of long term capital gains with immediate effect or in earlier Finance Bills about change in system of taxation of capital gains and one can find several examples of such cases which caused significant despair all around. If we had well documented Taxation Policy, could this have been avoided?

### Implementation Mechanism

This part of the Taxation Code needs to state the implementation mechanism of the principles outlined in the Policy Statement which could include organisation of tax administration, manner of escalation of issues, identification of tax gaps, recovery mechanism, enforcement, tax payer facilitation and like.

Take the aspect relating to escalation of issues. Say, one officer, on his scrutiny of a case, forms a view that there is leakage of tax revenue which is essentially on account

of interpretation of the law. In today's scenario, the tax officer issues a pre-audit notice or show cause notice for past five years and if amounts are large, it becomes a major news item having bearing on capital market and company's own financials. As per current practise, this would take several years to settle as decision will finally be taken by the highest Court of the land.

Could a mechanism be introduced that in such cases, the issue is escalated to a special unit within the Central Board, Direct or Indirect Taxes, as the case may be, which quickly, in a time bound manner, examines the same and takes a view in the matter. As far as possible in such cases, the matter needs to be fast tracked if it is decided to litigate. Alternatively, if the view is that the law/rule is not clear, the law/rule should be amended/clarified with prospective effect to address the issue and matter could be closed. There are several such industry level issues pending under erstwhile Service Tax Law and new Goods and Services Tax Law, some of which are at High Court level. One only shudders at the possible impact it would have on these companies.

Take the case of revenue targets set for specific divisions. Could the targets not be based on assessment of industry performance and revenue gap estimations based on effective data analytics ?

Some industries/businesses may be going through challenging times and not able to pay taxes in time. Could there be a mechanism for either the tax payer or even the tax department reaching out to the tax payer to understand the financial situation and work out instalments for tax payment. Trust and faith in both the tax payer and the tax officers is key for implementation of such initiatives which do exist in developed jurisdictions.

We also hear that in some developed jurisdictions, if there is fire or any damage caused by natural disaster, the tax officers visit the tax payer, understand the impact on business and work out reschedulement of time for payment of taxes.

There are many areas which require a more reasoned and practical approach and the list would be long. This would include quicker redressal of grievances ( current position needs to be assessed to understand and appreciate the challenges), maintenance of common database to obviate need for providing same information several times, plugging leakages of input tax credit under indirect taxes due to breaking of chain, difficulties in faceless assessment/appeals ( though, objective is laudable, ground reality is different ) , need to introduce dispute settlement mechanism and many more. The underlying theme should be facilitation of tax payers.

In a nut shell, a mind-set change is the need of the hour! Create an environment for all, corporates, capital markets and government, to thrive in a fair, transparent, accountable and tax payer friendly regime.

<sup>1</sup> Mr Ravi Agrawal as reported in Free Press Journal, online version; 03.07.2024

<sup>2</sup> In terms of powers contained in Section 119A inserted with effect from 1.4.2020

<sup>3</sup> "119A. The Board shall adopt and declare a Taxpayer's Charter and issue such orders, instructions, directions or guidelines to other income-tax authorities as it may deem fit for the administration of such Charter."