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Align Policy Measure with Software and Tax Administration, with Accountability for Outcome Monitoring

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The Theme

Consistent with global trends, India has increasingly shifted from manual to digital methods in administering taxes. This process is still under way and greater shift to digital methods is expected, including in India's 28 states and 8 Union Territories. This shift has been combined with increasing investments in hardware, software, and human expertise in third party data assimilation, data analytics, and artificial intelligence (AI) by the tax policy organizations and administration.

Much commendable progress toward modern tax administration in India has been made in a relatively short time. But the task of reforming tax systems is never done as it is a process and not an event, and as new challenges arise with changing circumstances.

In the Goods and Service Taxation (GST), all the compliances and administrative processes are routed through the GST Network, a software platform. GSTN is a not-for-profit company equally owned by the Union Government (50 Percent Share) and all states combined (50 percent share).

In the Income taxation, both personal and corporate, many compliances and administrative processes have already been made digital. There is an explicit policy focus to increasingly make as many of the work processes digital as possible. The Finance Minister, in the 2020 budget session, announced the introduction of E-appeal mechanism in the Income Tax Law, taking forward the E-assessment process announced in the 2019 budget. This reflects the determination of the Government for speedy digitization of tax processes.

The digitization of tax processes is essential for efficient management of mass (big) data, and represents a mechanism with potential to provide ease in tax estimation, filing, and compliance, as well as for transparency. However, digitization is not likely to result in desired outcomes if the digitized tax processes are not coherent from a systemic perspective; and are not aligned with software used, with work attitudes of the tax administrators, and with monitoring of the work done by tax organizations and officials and its consistency with announced tax policies.

It is essential that the statistics generated from monitoring should be made accessible in a timely manner. The pace of digitization should be consistent with the available infrastructure, including with the tax administration.

Select Examples from the Income Tax and the GST

The rest of the column provides examples in the context of the above theme by discussing the select tax processes which have been digitized or proposed to be digitized for the Income Tax and for the GST. There are more such examples, but are not included due to space constraint.

The 2020 Union Budget projects Corporate income Tax revenue of INR 6.8 Trillion; Personal Income tax of INR 6.2 Trillion; and GST of INR 6.9 Trillion. These figures are before constitutionally mandated devolution to the states. The three taxes are the key pillars of tax receipts, and therefore any improvements in their functioning will also help in strengthening India's fiscal position.

Income Tax

The E-assessment process in the Income Tax Law has been mapped and elaborated in a notification issued in 2019. It is highly probable that the similar process would be mapped in the case of E-appeals. An analysis of the proposed process however suggests that one tax official will review the documents submitted by the tax payer for assessment; the personal hearing will be undertaken by another tax official, and based on this personal hearing by way of video conferencing, the first tax official will pass the assessment order without having any interaction with the taxpayer.

It is argued from the perspective of practicalities as they exist currently in the country, the process may require significant refining to ensure fairness (perception of it as well), ease of compliance, objectivity, and timely and due revenue generation.

The process of making an assessment or appeal order requires exercise of judicious skills by the officer. When one officer reviews the documents, but the other officer conducts personal hearing, how would the judicious exercise of power be ensured in passing the order? This process has the potential to result in perceived unfairness and litigation, with consequent adverse effect on revenue generation.

The tendency of the taxpayers (aided by tax advisors) to game the system may further contribute to potential litigation. Therefore, addressing the behavior of these two stakeholders is also essential.

Exhortations of duty of taxpaying by the Prime Minister are commendable and helpful, but more specific measures are needed. All well regarded tax and tax administration systems have high degree of voluntary compliance, aided by appropriate systems and social environment.

The situation becomes more critical in the prevailing Indian conditions where standard conclusions may not be drawn from the accounting statements of different taxpayers; as these need to be understood in the context explained by the taxpayer. The 100 percent completely digitized tax processes as designed at present may adversely impact on fairness, as judicious views are to be taken based on thorough examination of both the facts and the law.

Direct Tax Vivad se Vishwas (from dispute to trust) Bill, 2020 was introduced in the 2020 budget. It seeks to resolve disputed tax cases worth INR 9.3 trillion. That such large outstanding amount exists is an indicator of the reforms needed in direct tax administration. The design, implementation, and monitoring of this scheme must be geared towards settlement, and not only revenue. The outcomes from this scheme need to be communicated.

The GST

There are situations, where the tax process is routine and mechanical in essence, but the manner in which the process is digitized leaves gaps for interface between the taxpayers and tax officials.

An example is GST ITC (Input Tax Credit) refund process. Although the refund applications are to be filed online with all the documents, there is no mechanism to ensure that the taxpayer would get online acknowledgement or refund order without interacting with the jurisdictional tax official. Often, tax official has to be reminded, who then sends the acknowledgment online. Then, the tax official would call the taxpayer to get the invoices verified, and only then refund order would be passed by the same official, which is processed through the GST Network. This suggests that the purpose of quick and easy compliance with tax regulations through automatic digitized refund process gets significantly diluted.

Refund is one tax process which is suitable for complete digitization. In most of the refund cases, the parameters for allowing refund may be mechanized. A cue may be taken from the refund process adopted in Income Taxation which is one of the most efficiently working tax process till date in India. The only cases, where interface of taxpayer with tax official is required are the cases where refunds may not be allowed mechanically and a judicial procedure is to be followed.

Another point worth mentioning in the GST refund process is with respect to 'time limitation' for filing a refund claim. The GST Law allows a taxpayer to make a tax/ITC refund application within two years of the relevant date. In the present refund process, if a taxpayer applies for refund and any deficiency is noted by the tax official in the documentation of application, the official simply rejects the application, rather than acknowledging the submission, and giving an opportunity to the applicant to rectify the application. After this, the claimant needs to file a fresh application for the same refund. The point is that as per the process, this new application also has to be made within two years of the relevant date without considering the fact that time limitation was over with the submission of the first refund application. This is in complete disregard of the respective legal provision in the GST Law. This work process also leaves possibility of legal disputes.

The size of the GST transactions is very large. Thus, as on February 10, 2020, according to the GSTN portal, there were 12.1 million tax payers registered; 415 million returns have been filed; 8230 million invoices have been uploaded; highest number of return transactions in a day was 2.4 million; and highest payment transactions in a day was 0.9 million.

The efficiency of the digitized system, with its software and capacities meeting such large and complex needs, is one of the pre-requisites for the smooth functioning of the tax administration process through such platform.

Considering the size of the user base of the GST Network and the system capacity, there have been many instances when the taxpayers could not file their tax returns or other documents within the given time frame. In such cases, the taxpayers either have to lose their tax benefits or have to pay penalty for delays in spite of complying with the regulations.

One such example is filing of GST TRAN1, which was a document for transfer of transitional ITC. It could not be filed by many within due dates because of technical issues resulting into huge number of litigations still going on in various high courts in India. A policy support needs to be provided for such cases so that a systematic rather than an ad hoc approach for such cases, which are becoming frequent, is taken.

The digitized tax processes have made big data and information analysis capability available to the tax officials. This is positive for the tax administration; however, the flip side is that in some cases the tax officials are using the big data to issue notices at mass level simply based on arithmetical differences or the standard accounting ratios.

For instance, if a taxpayer is having lesser revenue in year 2 than the revenue he earned in the year 1, he may get a notice from the GST tax official to explain the reason for the lesser revenue; or one may get notice to explain the difference in the figures of GSTR-3B and GSTR-1 within 2 months of filing the returns although there is no modality to revise such returns in the law or the software. The annual return is the appropriate occasion for the taxpayer can align such differences. The number of notices a taxpayer is receiving in the GST regime have multiplied in comparison to any past tax regime, which was definitely not the intent of the tax policy.

Concluding Remarks

India is in early stages of learning curve for establishing and adjusting to the digitized tax environment. The technology can bring in significant tax efficiencies and convenience to the taxpayers.

It is strongly suggested that for India to modernize its tax administration, deliver desired outcomes, and make it globally competitive (just as the corporate income tax has become globally competitive), the following need to be urgently considered.

- The extent and manner of digitization of the tax administration processes should be aligned with the work behavior of tax officials, skills set needed, digital system infrastructure and tax policy objectives of the country.
- Complete digitization of those processes which can be mechanically done without any interface between the taxpayers and the tax officials would certainly lead to tax efficiencies.
- Complete digitization of the processes which require exercise of judicial skill on the part of the tax officials need to be refined to give greater weight to fairness (including perception of fairness). Interface of the taxpayer with the same officer who is going to pass the respective assessment or appeal order, if done through video conferencing, can help align the tax policy intent, the processes, and outcome. The outcomes must be monitored and communicated for generating appropriate incentives and disincentives for both tax officials and tax payers.
- The tax officials must have appropriate infrastructure in terms of motivational and technical training, systems and resources before the digitized processes are initiated.
- A continuous monitoring mechanism must be introduced to analyze the appropriate working and sophistication of the software processes if the policy intent is to be realized.
- A policy support is required to deal in the guided manner with the situations where taxpayers are not able to fulfill their obligations because of technical issues.

- Policy codes for guidance in cases of system deficiencies and the manner of using the data of the taxpayers judiciously by tax administration may create more conducive environment for digitized taxation system in India.
- A policy on final closure of income tax and GST needs to be explicitly formed, including when the tax payable is under litigation. This should balance the needs of the taxpayers with those of the state.
- There should be an explicit policy (perhaps included in the proposed Taxpayer Charter) for regular and timely publication of detailed taxpayer statistics for research and analysis, albeit with appropriate safeguards.

Releasing sporadically such data as amount of exemptions taken in the aggregate and by different income brackets for personal income tax, and for corporate income tax (for which number of corporations opting for new lower tax regimes should also be available). The GSTN may consider releasing time taken for the refund process and the amounts refunded. Speedy refunds, including on exports are among the key indicators of efficiency of GST administration.

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