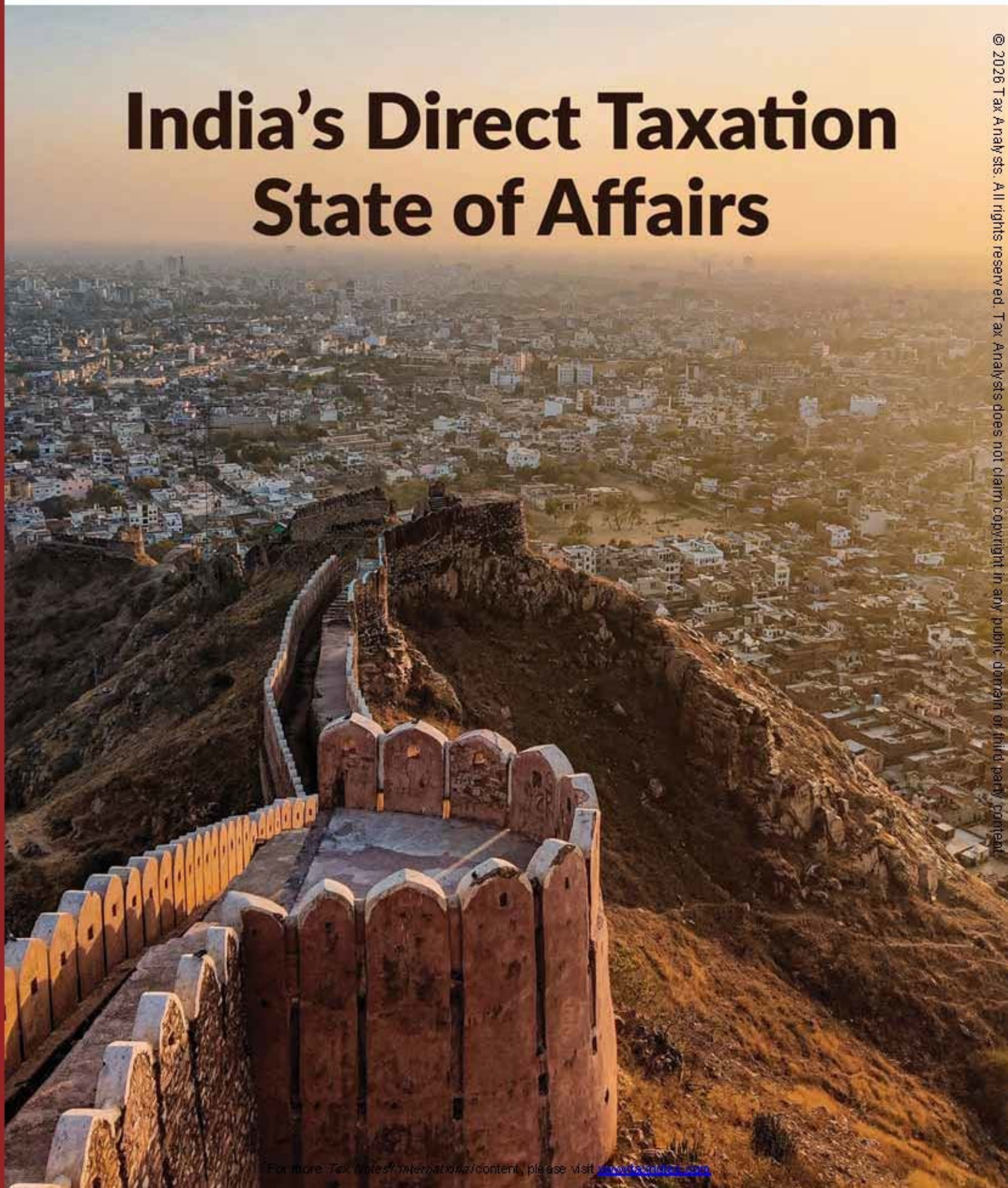
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India's Direct Taxation State of Affairs



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Direct Taxation in India: The State of Affairs

by Parthasarathi Shome

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In this report, Shome explores recent developments and achievements in direct taxation in India.

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Introduction

This report addresses achievements and challenges in the area of direct taxation in India in recent years. It includes the individual income tax, corporate income tax, sundry other taxes, and selected issues in tax administration. My comments reflect recent experiences, discussions, and conclusions.

Individual Income Tax

Increased Flexibility for the Individual Income Tax Payer

The individual income tax structure in India has continued to be simplified and the standard deduction steadily increased. This is a salient feature in a country in which there has to be constant awareness of the cost of living of the middle class, who come under the purview of the income tax, and for whom a cushion has to be provided against fiscal drag or bracket creep, that is, they are not dragged into higher tax brackets merely because of inflation as opposed to real income increases.

Taxpayers have been given the choice to select from two tax regimes. The new regime, introduced in the 2020-2021 central government budget[1] (April 1-March 31), has seven marginal rates (0 percent, 5 percent, 10 percent, 15 percent, 20 percent, 25 percent, and 30 percent) that result in a lower tax burden for some taxpayers in particular who suffered earlier by being pushed into a higher tax bracket in times of inflation. Now the next higher

[1] India's fiscal year is from April 1 to March 31.

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tax rate is lower than in the earlier regime. A tax rebate (section 87A) is allowed in the new regime for incomes up to INR 1.2 million,[2] together with a standard deduction of INR 75,000 for salaried individuals. But it does not allow most deductions allowed under the old regime such as section 80C, 80D, or the house rent allowance described below.[3]

Selection of the older or legacy regime requires return filers to opt out of the new system. The old regime has marginal rates of 0 percent, 5 percent, 20 percent, and 30 percent. A tax rebate (section 87A) of INR 12,500 is applied (that is, INR 500,000 income is tax free). Also, a standard deduction of INR 50,000 for the salaried, together with age-based exemption limits, are applied. It also allows various exemptions and tax-saving investments including section 80C — public provident fund and equity linked savings scheme (up to INR 150,000), section 80D (related to health insurance) (up to INR 25,000) (or INR 50,000 including parents), and house rent allowance (calculated from salary).

Marginal Income Tax Rates

As against the restructuring of rates and the choice available to taxpayers between the two regimes, the structure of the marginal income tax rates at the upper end does not reflect the high growth rate of the economy. While India's income inequality has reduced in recent years, reflecting government welfare programs, including subsidized food and direct financial transfers, its wealth remains highly concentrated. The highest 1 percent of the population owns 40 percent of the wealth while the top 10 percent owns 65 percent. The share of wealth for the bottom half is 6.4 percent according to the World Inequality Report 2026.

Equality cannot be enhanced comprehensively through transfers alone but requires the enablement of wealth generation by the middle and lower middle classes. Raising the top income tax bracket from 30 percent to 35 percent and 40 percent while widening the lower brackets, should help build new wealth in the lower brackets without affecting revenue adversely. That would also provide the possibility of investment-led economic growth from the middle to lower economic groups. Raising the top rates would also make the rate structure more internationally comparable.

There are three reasons why this should be done. The first reflects the high growth rate that the economy has achieved in the new millennium, signifying increased taxability of the upper-income groups that are benefitting disproportionately from wealth inequality.

The second reason comprises the introduction and broadening of the goods and services tax. It is well known that as household incomes decline, consumption as a proportion of household income increases. The GST, which falls on consumption, is therefore recognized as a regressive tax. As its coverage or scope broadens, the GST tends to become more regressive over time. Higher top marginal income tax rates should contain some of the adverse distributional consequences of the GST.

The third reason is the advent and expansion of robots and artificial intelligence in the economy that will replace blue-collar employment, if not white-collar employment. In turn, this will require retraining on a broad scale, the financing of which would bear on the government's fiscal budget. Based on these reasons, higher income tax rates should be added at the top of the structure.

Taxation of Second Abode

An aspect that had existed in the individual income tax structure that was distributionally adverse was the exemption of only one home *pari passu* with the taxation of attributable income from a second home. This was the case irrespective of the value of the first home, with some glaring examples staring at taxpayers.

This was modified in the 2019 interim budget. Accordingly, the prevailing 2025-2026 position is that you can declare up to two properties as

[2] INR 100 = $1.05 as of July 9, 2026.

[3] In 2023-2024 the new regime underwent changes to the brackets, an extension of the standard deduction, and a raising of the exemption for encashment of leave for retirees, among other features that made the structure more attractive to taxpayers.

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self-occupied with a "nil" annual value, i.e., no notional rent is attributed to them. This is a significant positive step that had been recommended by researchers and committees for several years. (A third or subsequent properties, however, are deemed to be let-out properties that are taxable on their market rental values whether they are rented out or not.)

There are some conditions attached. Thus, the overall deduction for home loan interest across both self-occupied properties is capped at INR 200,000 per annum if a taxpayer selects the old income tax regime. The new regime does not allow it at all, cutting back incentives being one of its objectives. A property acquired or constructed with borrowed capital must be completed within five years of the borrowing. If not completed, the INR 200,000 deduction declines to INR 30,000.

If the property is rented out, interest deduction is unlimited. If income is less than interest paid, then the loss that is set off against other heads or types of income is restricted to INR 200,000, and the balance is carried forward. An INR 150,000 deduction is allowed on principal repayment across home loans, but this is a part of section 80C covering all investments, including provident funds and others.

The second home, however, is subject to capital gains tax at regular rates. However, if held for 24 months, it is considered long-term capital gains charged at 20 percent with indexation, and 12.5 percent with no indexation. Despite the important attempt to simplify the income tax structure, the authorities should seek further avenues in the future to simplify the overall structure to make it more convenient and beneficial for the taxpayer.

Corporate Income Tax

Option to Select the Base of Corporate Income Tax

The object of this reform could be said to be the encouragement of micro, small, and medium enterprises. An optional reduced rate was introduced at 22 percent (section 115BAA) through a September 2019 amendment in which the taxpayer would have to forgo certain otherwise allowable deductions, such as special economic zones (section 10AA); additional depreciation for new plant and machinery; investment allowances in notified backward areas; sector-specific deductions for tea, coffee, or the extraction of petroleum; scientific research and skill development; and some donations. This was a unique feature in that the income tax offered flexibility to the taxpayer to select a lower tax rate by foregoing tax incentives if it was better for the business's bottom line — post-tax profit. This was therefore a commendable step in the corporate income tax (CIT) structure.

There are two critiques. First, the structures of the applied surcharge and cess must be simplified. In a 2019 change, while the regular CIT rate was maintained at 30 percent,[4] it was reduced to 25 percent for businesses with a turnover of less than INR 4 billion. But the topping of surcharge and cess raises the effective tax rate, and it is not known if revenue is earmarked for specific purposes because it goes into the consolidated government budget. Second, more needs to be done in scaling back tax incentives allowed at the higher tax rates because they continue to cause inefficiency in resource allocation by distorting relative prices as well as being iniquitous across the spectrum of the corporate sector.

Union Budget Annexure 7 lists tax expenditures — revenue forgone because of incentives — in the "Statement of Revenue Impact of Tax Incentives Under the Central Tax System," published as part of the Receipts Budget document.[5] It reveals that the revenue loss from tax incentives has continued to bear down over the two decades since 2006, a period during which it has been monitored.

Minimum Alternate Tax

Some countries have had a minimum tax on corporate income to circumvent the revenue-depleting ramifications of various tax incentives given to the corporate sector. The United States has a corporate alternative minimum tax of 15 percent on the adjusted financial statement

[4]The 22 percent CIT rate applies an additional 10 percent surcharge. The 25 percent and 30 percent CIT rates apply the surcharge at 7 percent or 12 percent determined by income. A 4 percent cess (for health and education) is applied on all three CIT rates.

[5]When it first appeared in Union Budget 2006-07, Annexure 12, it was termed "Statement of Revenue Forgone."

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income of companies whose three-year average annual adjusted financial statement income exceeds $1 billion. Canada has a minimum tax on the mining sector at the provincial and territorial levels ensuring revenue contributions despite low profitability on the books, for example, during years of lumpy capital investment. The EU has a minimum corporate tax rate of 15 percent (pillar 2 rules).

Several Latin American countries have experimented with an alternate calculation of the corporate tax base defined as the gross assets of corporations but charged at a considerably lower rate than the regular CIT rate. The tax paid was the higher of the two calculations. The rationale for a minimum tax based on the gross assets of a company may be explained as follows.

Let us assume that the return on the gross assets of a company must be 6 percent for it to remain solvent in the medium term. Second, say that the CIT rate is 25 percent. If the minimum tax is based on gross assets, the tax rate would be 25 percent on the 6 percent return, or 1.5 percent of gross assets. Mexico had such a tax for some years but subsequently abolished it despite incorporating carryforward and other features. Brazil, too, had such a tax but shelved it at 0 percent, presumably so that it may be reintroduced without the need for new legislation. Some other Latin American countries designed similar taxes but they were eventually removed. Experience reveals how difficult it is for policymakers in emerging economies to clip the wings of tax incentives. But efforts must continue.

Emergence and Trajectory of Indian MAT

India's minimum alternate tax (MAT) was introduced at 15 percent as section 115J within the scheme of the CIT in Finance Act 1987.[6] Its base is book profits, defined as net profits per the books after making specified adjustments as shown in Table 1. The adjustments changed over time in a quest for rationalization though they also seemed to reflect fluctuations in revenue needs. Indeed, the MAT has played an important role as an instrument to improve the revenue productivity of the CIT. The fluctuations in its structure reveal the extent to which it has been the subject of discussion, debate, and redesign.

A brief history may be useful. Some years after its introduction, the Advisory Group on Tax Policy and Tax Administration for the Tenth Five-Year Plan (2002-2007) found that, in assessment year (AY) 2000-2001,[7] in a sample of 1,816 companies, 1,293 profit-making companies had a final tax liability of 25.95 percent of their profits before tax, in contrast to a statutory corporate tax rate of 38.5 percent. Consequently, improvements in the MAT structure were recommended to improve the ETR for garnering additional revenue.[8]

Computation of MAT

If the income tax payable on the total income of an assessee, being a company, as computed under the Income Tax Act, is less than 18.5 percent of the book profit of a company, the book profit is deemed to be the total income of the assessee and the tax payable by the assessee on total income is the amount of income tax at the rate of 18.5 percent. Table 1 illustrates the calculation method of book profit.

An AMT was introduced in AY 2012-2013 on noncorporates — individuals, partnership firms, limited liability partnerships, and a tax classification called Hindu undivided families (HUFs) — that claimed specified deductions. It was levied at 18.5 percent plus surcharge and cess, subject to threshold conditions. Thus, both companies and noncompanies satisfying relevant statutory conditions are subject to an AMT in India under which specified deductions that are allowed under both tax categories are disallowed. (See figure.)

The figure illustrates the time series of both CIT and MAT rates from AY 1988-1989 to AY

[6] Finance Act, 1987, would be applicable from fiscal 1987-1988 or assessment year 1988-1989.

[7] In India, the assessment year follows one year after a financial year because it denotes the year when tax assessments are carried out.

[8] A simple regression between the CIT rate and the MAT rate revealed that one-third of a change in the MAT rate could be explained through a change in the CIT rate, explaining the role of MAT in raising the revenue productivity of the CIT.

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Table 1. Computation of Book Profit

Net profit	Net profit as per the profit and loss account for the relevant previous year, in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 2013
Increase[a]:	a) amount of income tax paid or payable, and the provision therefor b) amount(s) carried to any reserves, by whatever name called, other than a "reserve" specified under section 33AC (for shipping business) c) amount(s) set aside to provisions made for meeting liabilities, other than ascertained liabilities d) amount by way of provision for losses of subsidiary companies e) amount(s) of dividends paid or proposed f) the amount(s) of expenditure relatable to exempt income [any income to which section 10 (other than the provisions contained in clause (38) thereof), section 11, or section 12 applies] g) amount of depreciation h) amount of deferred tax and the provision therefor i) amount(s) set aside as provision for diminution in the value of any asset
Reduce:	i) amount withdrawn from any reserve or provision, if any such amount is credited to the profit and loss account ii) amount of exempt income [to which any of the provisions of section 10 {other than the provisions contained in clause (38) thereof}, section 11, or section 12 apply, if any such amount is credited to the profit and loss account] iia) amount of depreciation debited to the profit and loss account (excluding the depreciation on account of revaluation of assets) iib) amount withdrawn from revaluation reserve and credited to the profit and loss account, to the extent that it does not exceed the amount of depreciation on account of revaluation of assets iii) amount of loss brought forward or unabsorbed depreciation, whichever is less, as per books of account (iv) to (vi) profits eligible for deduction under sections 80HHC/80HHE/80HHF — omitted vii) amount of profits of sick industrial company viii) amount of deferred tax, if any such amount is credited to the profit and loss account

Source: Table constructed from the provisions of Schedule III, Indian Companies Act. Courtesy of Navneet Manohar (2013).

[a]Items (a) to (i) are increased to book profit if the same are debited to the profit and loss account and (j) if the same is not credited to the profit and loss account.

2020-2021, revealing the variability of both over time. The CIT rates shown include the surcharge and cess levied on the CIT rate, which makes the composite CIT rate different from the specified headline rate.[9]

The MAT was abolished by Finance Act 1990 possibly because it was considered complex and difficult to administer. Nevertheless, as aggressive tax planning and the phenomenon of zero-tax companies continued, it was reintroduced at a rate of 12 percent through section 115JA of the Finance Act 1996.

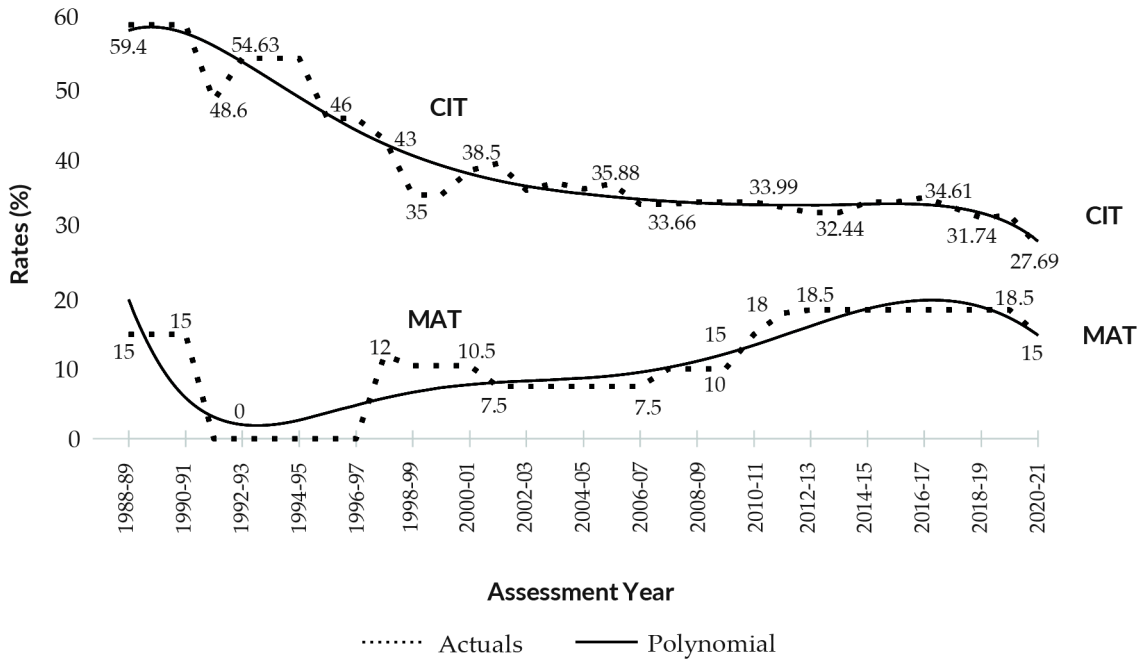
The MAT's base was larger than the one in the erstwhile provision because profits comprising foreign exchange earnings were not exempted. A rationalization was introduced through a carryforward provision. It comprised a set-off of the excess of MAT liability over "actual" liability against any excess of "actual" liability over MAT liability in the subsequent five years.

Finance Act 2000 changed course from section 115JA through a new section 115JB that provided for a significant reduction in the MAT rate to 7.5 percent of book profits — against a CIT rate of 38.5 percent — to reflect the removal of several tax

[9]A convenience from the central government's point of view is that revenue from these surcharges does not have to be shared with state governments.

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Source: Parthasarathi Shome, *Taxation History, Theory, Law and Administration* 218 (2021).

incentives, including for exports (though those for the IT sector continued under zone-based policies, research and development credits, and infrastructure subsidies).

Also, the revenue calculation moved from income basis to tax basis. Under section 115JA, if the total income of an assessee was less than 30 percent of its book profit, the tax base would comprise 30 percent of that book profit. On the other hand, section 115JB provides that if the income tax payable on the company's total income is less than 7.5 percent of its book profit, the tax payable will be 7.5 percent of the book profit. Also, once the tax liability is determined, it will be increased by the surcharge.

These changes, together with an increase in the dividend distribution tax through Finance Act 2000 from 10 percent to 20 percent, tended to increase the ETR of corporations (if the dividend distribution tax were deemed to fall on corporations).

The rate of MAT remained at 7.5 percent of book profits for six years. In AY 2007-2008, it was increased to 10 percent while the CIT rate was reduced to 33.66 percent. The MAT rate was again increased to 15 percent in AY 2010-2011. It was increased further to 18 percent in AY 2011-2012, and again to 18.5 percent in AY 2012-2013. It remained at that rate until AY 2019-2020. Subsequently, the MAT was reduced to 15 percent from AY 2020-2021 *pari passu* with a considerable reduction in the main CIT rate, which was reduced to an average of 27.69 percent (see figure).

Therefore, it could be said that the CIT and MAT rates began to approach each other from around 2007-2008. Most companies would be paying at least the MAT rate or a bit more, but the excess CIT paid could be carried forward for five years. It could be speculated that, over time, the government expected most companies to pay at or around the MAT rate — that is, the minimum, and not much more.

To conclude this point, a MAT is employed in some form or other because countries are unable to cut back on the tax incentives they provide in the form of regional incentives, size of capital investment, size and nature of labor employment,

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export industries, IT and, more recently, startups, including in robotics and AI. Yet studies have consistently revealed that tax incentives have generally failed to produce the desired results in economic growth other than through the capital investment vehicle, and in this case too selectively.

The FBT and BCTT Experiments

A discussion of recent Indian taxation cannot bypass the fringe benefits tax (FBT) and banking cash transactions tax (BCTT) because of their ramifications and simultaneous introduction and abolition.

Fringe Benefits Tax

In the early 2000s there was a general perception that individuals did not honestly report as income the fringe benefits that they received from their employers. Borrowed from international examples, the FBT was introduced in India in the 2005 central budget as an additional income tax levied on employers for perks and amenities given to employees. Various fringe benefits were listed, categorized, and values presumed, comprising the tax base. The tax rate was the same as the CIT rate and applied to the base.

Conceptually, the FBT was not a poorly designed tax. What made it nonfunctional was the persistent questioning by tax officers of the taxpayers' recordkeeping and their dissatisfaction with taxpayer records of expense bills. Thus, a conceptually correct tax became impossible not only to comply with but also to administer. It was unpopular right from the start — perhaps it was too "taxing" for the mindset of the Indian taxpayer and their tax administration counterparts. Some powerful news dailies were extremely critical of the tax, and the FBT was removed by a subsequent finance minister in the 2009 central budget.

Bank Cash Transactions Tax

The story of BCTT is somewhat different. It was also introduced in the 2005 central budget to track down "black money" or unaccounted-for cash and bring it within the tax base. A tax of 0.1 percent was imposed on cash withdrawals from banks exceeding INR 50,000 in a day for individuals, and INR 100,000 for others.

When the tax was contemplated, bank chairs were called in and most agreed that they could administer it. Technical professionals from the largest public sector bank worked out an algorithm for monitoring withdrawals. It was shared with all banks.

The BCTT was imposed on May 1, 2005. A hue and cry arose from a small coterie, as could be expected, though the media were generally supportive. Nevertheless, BCTT was abolished in 2009. The reason why remains a mystery. The declaration that other financial information-gathering instruments had been identified to address the problem was surprising.

Faceless Assessment

Current Practice

A feature that was introduced through Finance Act 2019 and applied from August 13, 2020, was "faceless assessment" of an assessee. This entailed the allocation of a tax return for assessment to an assessing officer anywhere in the country.

There is no provision for an assessing officer to ask an assessee to appear in person for any query. The taxpayer's response to a query has to be filed online, though, as per prescribed procedures, a personal hearing can be sought by the assessee.

An assessee may feel that there is no option but to seek a personal hearing when facing a show cause notice. This usually occurs when a show cause notice is issued by the assessing officer with a proposed variation in the tax contribution. The system has led to a chimera of administrative efficiency and is unpopular with both the assessee and the assessing officer.

The need for online filing of submissions is not contested. However, mechanisms need to be developed to curtail the uploading of thousands of pages of attachments to the response submitted. The result is that officers may be ignoring these attachments uploaded without appropriate referencing before passing orders.

On the other side, a taxpayer's email and online portal may be handled by a chartered accountant who may not respond to the notices. These cases result in ex parte orders causing hardship to the taxpayers.

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Ultimately, the system of faceless assessment suffers from a lack of ownership in an assessment because no name of any officer is attached or revealed. Even erroneous orders occur. Hence the overall quality of assessments has declined and litigation appears to have increased.

The Need for Reform

Faceless assessment should remain but needs reform. It may be beneficial for the settlement of taxes for noncomplex tax returns such as for employees, retirees, and some others. These taxpayers should populate the catchment area of faceless assessment. Thus, ITR-1[10] filers could be covered under faceless assessment. For other individuals, a better structure would be: ITR-2 (individuals with capital gains), ITR-3 (individuals with business income), and ITR-4 (presumptive income category) filers[11] being given flexibility to opt out of faceless assessment.

However, for complex returns such as ITR-5 (firms and limited liability partnerships), ITR-6 (companies), and ITR-7 (charities) with voluminous submissions, faceless assessment has become a lose-lose situation. This would improve if high-risk and complex large businesses and corporate cases are excluded from faceless assessment.

Direct Tax Issues Arising in the International Context

Taxation of Indirect Transfers

A multinational enterprise owns assets in India. Its headquarters are abroad. It sells its India-based assets to another MNE also headquartered abroad. There is no transaction that takes place between them in India. This is called an "indirect transfer" of assets between MNEs because the transfer does not involve any transaction in India even though the transfer is of India-based assets.

A controversy arose in India regarding the taxability of indirect transfers and whether the revenue should come to the Indian exchequer or to the exchequer of the location in which the foreign entity is tax resident.

For example, Vodafone acquired India-based assets from Hutchison, both MNEs headquartered abroad, for its India-centric operations. It was an indirect transfer. At the time of completion of the transaction, the Indian tax authorities asked Vodafone to apply tax deducted at source on Hutchison. Vodafone declined, stating that no Indian tax law required it to do so.

Subsequently, the Indian authorities retrospectively changed the law to make indirect transfers taxable and imposed a penalty on Vodafone. Vodafone litigated the matter, losing in Bombay High Court but winning in the Supreme Court.[12]

The government formed an independent expert committee to look into the matter in August 2012.[13] The committee's October 2012 report did not express any adverse view on taxing indirect transfers as such. But it opposed taxing it retrospectively. That would create an environment of "impossibility to perform" for any functioning enterprise.

Here, risk is to be differentiated from uncertainty. Given a tax law, risk can be modelled by an entrepreneur reflecting his attitude toward risk — averse, neutral, favorable — based on which business decisions can be made. But retrospectivity would lead to the creation of uncertainty in business operations. Ongoing business operations would be subject to unmodelled taxes on income and profits, thus giving rise to an "impossibility to perform" situation for business operations.

The draft expert report was widely acclaimed though the then existing government did not formally act on the matter. The subsequent (current) government publicly announced that it would not apply tax law retrospectively, even though it desisted from abolishing the law that effectively allows retrospective application.

[10] ITR-1 is for resident individuals with income less than INR 5 million from salary, pension, two house properties (with no brought-forward loss), interest, and agricultural income of INR 5,000 or less, as well as selected categories of capital gains up to INR 125,000.

[11] ITR-2 is for individuals and HUFs who have no business or professional income but have income exceeding INR 5 million, capital gains, foreign income or assets, are a company director holding unlisted equity shares, or are a nonresident Indian.

[12] *Vodafone International Holdings B.V. v. Union of India*, [2012] 341 ITR 1 (SC).

[13] The expert committee was chaired by the author.

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General Antiavoidance Rules

General antiavoidance rules came up in the context of both domestic companies and MNEs. They were introduced in India as tax instruments in 2012 but were heavily criticized and put in abeyance. The government formed an expert committee in July 2012 that submitted its report the same year though the law was finally legislated in 2017, being applicable from AY 2018-2019.[14]

The original Indian GAAR was to be applied if a taxpayer had entered into a business arrangement whose "main purpose" was to obtain a tax benefit, and the arrangement was: (i) not normally employed for bona fide business purposes, (ii) not arm's-length, (iii) abused the provisions of the Direct Tax Code, or (iv) lacked economic substance.

The expert committee made several recommendations — while ensuring that tax avoidance was minimized — to make sure that the GAAR did not become a mere "tax collection instrument." Effectively, "grandfathering" was recommended for cases pending from the original (2012) to the date of final legislation. A proposed approval panel, to consider and sign off on every GAAR case, was recommended to include an independent expert — external to the tax administration — as a member, to obviate any "presumption of purpose" that a taxpayer's objective was to obtain a tax benefit.

However, litigation continues over GAAR cases. In the ongoing case of *Tiger Global*,[15] the Supreme Court ruled in favor of the tax department and cited the 2012 expert committee report. Thus, a particular investment may be covered through grandfathering, but not the entire arrangement. According to the ruling, grandfathering an entire arrangement would make possible the exclusion from GAAR scrutiny all future investments made through the grandfathered arrangement. Therefore, it said grandfathering an entire arrangement could not have been the intention of the grandfathering clause.

Taxation of Digital Services

The question that has challenged tax authorities persistently is how to tax the supply of digital services, a sector that has grown phenomenally. The OECD proposed the concept of a permanent virtual establishment (PVE). Profits from an MNE attributable to the PVE would accordingly be taxed by the source jurisdiction in which the income is generated. For this an MNE's significant digital presence would be essential in the source country — for example the maintenance and carrying on of business through a website — that would enable the taxation of profits from the supply of digital goods and services.

The popular method of taxing digital services has been a withholding tax on payments made by residents of a country for digital goods or services provided by a foreign e-commerce provider. This would bring PVEs with no physical presence into the domestic tax base.

The United States has opposed taxation based on the source principle, instead preferring residence-based taxation. Most digital service MNEs are resident in the United States, and application of the source principle would slice and distribute their profits along their global supply chains.

Nevertheless, several advanced and emerging economies introduced digital services taxes unilaterally. India introduced digital taxation as a 6 percent Equalisation Levy on online advertisements in 2016. Other countries to introduce a DST include Austria, Brazil, the Czech Republic, France, Indonesia, Italy, Spain, Turkey, and the United Kingdom. The EU has also introduced a DST. In 2019 the Office of the U.S. Trade Representative (USTR) found that France's 3 percent DST was unreasonable, unfair, and discriminatory toward U.S. commerce. It argued that because the DST was applied on revenue rather than on income, it was inconsistent with accepted principles of international tax policy. To retaliate, the United States proposed a 100 percent tariff on French cheese and wine. In January 2021 the USTR found that India, Italy, and Turkey discriminated against U.S. tech firms.

The controversy continues. The *Financial Times* of June 27, 2026, reported that the United States has announced that it will impose a

[14] Ministry of Finance, "Final Report on GAAR Income-Tax Act, 1961" (Sept. 30, 2012).

[15] *Authority for Advance Rulings v. Tiger Global International II Holdings*, [2026] 485 ITR 214 (SC).

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Table 2. Characteristics of Tax Instruments for Robots

S. No.	Tax Instrument	Neutrality of Labor/Capital Treatment	Design	Revenue Potential
1.	Tax based on rate at which robots replace labor	Yes	Achievable, but challenging to design	Medium
2.	Quasi-income tax on hypothetical robot salary	Yes	Achievable	High
3.	Disallowance of tax deductions	Depends if relative labor/capital treatments improve	Easy	Medium
4.	Similar incentives for robots and labor	Yes	Achievable, but irrational	Low
5.	Scale back depreciation rates for robots	Depends if relative labor/capital treatments improve	Achievable	Medium
6.	VAT/GST on robot activities	Yes	Easy	High
7.	Levy of selective excise duty	No	Achievable	High, depending on rates

Source: Parthasarathi Shome, "Taxation of Robots," Asian Development Bank Governance Brief, at 5 (Mar. 2022).

100 percent tariff on all goods imports from European countries that implement a DST.[16] In the meantime, the EU has been pursuing an EU-wide DST, declaring in June that a fragmented approach would be "bad for business . . . bad for trade and investment . . . [and] bad for growth." This reflects the frustration associated with international taxation in which national interests — even among advanced economies — are in conflict.

The New Frontier: AI

AI, including robots, is making relentless progress in complementing or substituting for human activity. Lists of economic activities that AI will sharpen and make more productive keep appearing. In June 2026 the *Financial Times* reported the share values of Accenture, a major IT company, have fallen to their lowest level since 2017. The consulting group cut its revenue forecast, leading to investor fears that the rapid advance of AI is undermining traditional IT and outsourcing businesses.[17] March-May 2026 bookings fell by 3 percent to $19.3 billion compared with the same period in 2025. Academic and corporate investigators are stepping up research on the potential impact of AI on employment.[18]

While AI is expected to have long-term beneficial ramifications for humanity, a counterpoint is that AI should make a fiscal contribution to societies if it replaces factors of production and their incomes. Thus, robots must be taxed as they replace white-collar and blue-collar labor who will need public resources for reskilling purposes.

Should robots be portrayed as individuals or juridical taxable persons? Should they come under the purview of income or consumption tax, or both? Table 2 shows that at the present level of practicality, it appears that a design based on excise taxation would be most suitable, though income taxation has to be explored as a future possibility.

[16]Peter Wells and James Politi, "Donald Trump Warns of 100 Percent Tariff on Countries Implementing Digital Services Tax," *Financial Times*, June 26, 2026.

[17]Stephen Foley, "Accenture Stock Hits Nine-Year Low as AI Fears Take Toll on Revenue Forecasts," *Financial Times*, June 18, 2026.

[18]"The New Seekers," *The Economist*, June 20, 2026, at 61.

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Concluding Remarks

Before concluding, an observation regarding tax policy and tax administration may be pertinent. Some countries may be undertaking a series of tax policy reforms through simplification of their tax laws. However, administration, that is, the application of subordinate law or rules, may not be uniform. Instead, good taxpayers should be identified in spite of the complexity of their tax returns. Their returns should be processed perhaps once in two or three years at most. This is an important element of the customer focus aspect that advanced tax administrations regularly employ.

At the other end of the spectrum are countries whose tax administration practices comprise relatively transparent implementation of the law. They have a clearly delineated and updated website on tax matters and a quick response mechanism through numerous customer response hubs. Yet they may have a tax policy structure that is extremely burdensome on the taxpayer, who may find it almost impossible to navigate through, and comply with, its complications.

Experience reveals that a typical taxpayer has little intention to evade tax, though they may be confounded by the tax law and find it difficult to comply with. It is the responsibility of the tax administration in both cases to simplify the law and administer it fairly before presuming the taxpayer is tax evasive, careless, or lackadaisical. Only when both types of challenges recede in importance can a tax structure and its administration be called advanced. At that stage there should be no pressure on tax officers to collect tax revenue, and it would be the responsibility of policymakers to avoid applying associated pressures on the tax administration. ■

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