

## Finance and Banking

### 2025 India Tax Reforms: GST 2.0 & DTC Guide

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#### Abstract

##### Evolution of the Indian Tax Ecosystem

*This chapter examines the transformation of India's fiscal policy from a fragmented, multi-tax regime to a unified digital framework. It analyzes the transition from the pre-GST era—characterized by the "cascading effect" and inter-state trade barriers—to the current Goods and Services Tax (GST) model and the forthcoming Direct Tax Code (DTC) 2025. By evaluating sectoral impacts, international benchmarks (such as the Australian model), and technical protocols like Input Tax Credit (ITC) matching, the study illustrates how structural reforms have enhanced economic efficiency. Furthermore, it highlights the shift toward "GST 3.0," where AI-driven audits and automated compliance aim to resolve federal-state disputes and bridge the tax-to-GDP gap. Ultimately, the chapter positions these legislative and digital advancements as the primary drivers for a transparent, investor-friendly, and simplified national tax architecture*

*Keywords: GST 2.0, Direct Tax Code (DTC), Cascading Effect, Input Tax Credit (ITC), Digital Compliance, Fiscal Federalism, Tax-to-GDP Ratio, GST Council.*

#### 1.1 Introduction: The Evolution of the Indian Tax Landscape

The structural integrity of a nation's economy is rooted in its taxation framework. For decades, India's fiscal architecture was defined by a fragmented dual-tax system that hindered trade and complicated assessments. The pre-2017 era was characterized by a "cascading effect," where the lack of a seamless credit chain resulted in taxes being levied upon taxes, inflating costs and stifling competitiveness.

In response, India transitioned toward "One Nation, One Tax" with the 2017 introduction of the Goods and Services Tax (GST). This reform replaced various central and state levies with a unified, destination-based consumption tax. Simultaneously, the direct tax regime is shifting toward the Direct Tax Code (DTC) 2025 to eliminate archaic complexities through a streamlined, data-driven approach.

This chapter explores the journey from manual, document-heavy compliance to "GST 3.0," where AI and real-time data serve as the standard. By analyzing historical challenges and future roadmaps, this study outlines how India is building a transparent, technologically advanced tax ecosystem designed for a multi-trillion-dollar economy

## **1.2 The Pre-GST Landscape: Structural Fragility and the Cascading Dilemma**

The pre-2017 indirect tax regime in India was defined by a complex, multi-layered structure where the Center and States operated within distinct, often overlapping, jurisdictions. This fragmentation created significant economic distortions, primarily through the "cascading effect"—a phenomenon where taxes were levied on taxes due to the lack of a comprehensive cross-tax input tax credit (ITC) mechanism. Economists estimate this cascading added 2-3% to the overall tax burden, inflating consumer prices and eroding competitiveness, especially for export-oriented sectors like textiles and manufacturing.

### **Pre-GST Tax Structure**

- **Central Levies:** Excise Duty (on manufacturing) and Service Tax (initially 12%, rising to 15% by 2016).
- **State Levies:** Value Added Tax (VAT, rates varying 4-20% across states), Central Sales Tax (CST, 2% without ITC), Entry Tax, Octroi, Luxury Tax, and Entertainment Tax.

The core complexities of this era included a multiplicity of taxes on single transactions—sometimes up to 7-8 levies on one supply chain leg—varied state-specific VAT rules (e.g., differing input credits for capital goods), and significant trade barriers such as physical check posts that hindered the free movement of goods. These inefficiencies led to price escalation (e.g., a commodity's final price could rise 25-30% due to embedded taxes), high levels of litigation (over 1.5 lakh cases pending by 2016), and logistical delays costing the economy an estimated ₹1.2 lakh crore annually in inventory holding. This necessitated the 2017 shift to the Goods and Services Tax (GST), which unified 17 taxes into one, boosting GDP growth by 1-2% in early years per NITI Aayog studies.

### 1.3 Income Tax Architecture: Complexity and the Direct Tax Code (DTC)

Direct taxation in India, governed by the Income Tax Act of 1961, has historically faced challenges stemming from its own longevity. Over 4,000 amendments since its inception have created a statute characterized by archaic language (e.g., references to "assessee" and manual computation norms), overlapping provisions (like multiple depreciation schedules), and frequent notifications that confuse taxpayers. This has resulted in a compliance cost of 1.5-2% of GDP, with small businesses spending disproportionate time on returns.

The Direct Tax Code (DTC) represents a multi-decade effort to replace this unwieldy act with a framework prioritizing simplicity, equity, and certainty. While early iterations in 2009 and 2010 faced resistance due to perceived tax hikes (e.g., removal of EEE exemptions on savings), the anticipated DTC 2025 focuses on "evolution sans revolution"—an incremental approach that balances policy continuity with digital synergy. Key additions include AI-powered pre-filled returns (already piloted via Faceless Assessment Scheme) and integration with Aadhaar for seamless verification, aiming to raise direct tax-to-GDP ratio from 6.5% to 8% by 2030.

### 1.4 Comparative Analysis: Pre-GST Indirect Taxes Vs. Income Tax

| Aspect     | Pre-GST Indirect Taxes   | Income Tax                      |
|------------|--------------------------|---------------------------------|
| Nature     | Indirect                 | Direct                          |
| Main Issue | Multiple taxes/cascading | Complex provisions/calculations |
| Compliance | Multi-authority returns  | Documentation-heavy             |
| Impact     | Price escalation         | Confusion/litigation            |
| Reform     | Replaced by GST          | Evolving (e.g., DTC talks)      |

### 1.5 Global and Domestic Perspectives on GST Implementation

Comparative studies highlight the diverse roles GST plays depending on the federal structure and economic focus of a nation. Globally, over 170 countries have adopted VAT/GST variants, but India's dual-model (CGST+SGST) is unique to its federalism.

**The Australian Model (Greg Smith, 2020):** In Australia, GST serves as a secure, hypothecated revenue source for subnational governments. While it provides a stable base for

States and Territories (yielding AUD 70 billion annually), it also highlights a "vertical fiscal imbalance" where states remain heavily dependent on Commonwealth transfers (up to 50% of budgets). Challenges include rural rebate schemes to offset regressivity.

**The Indian Sectoral Impact (T. Vineethan, 2024):** Empirical evidence from Kerala's tourism sector shows that GST reforms have driven significant improvements in financial, marketing, and operational efficiency by eliminating cascading effects and simplifying compliance. Turnover in the sector grew 15% post-GST, with ITC claims rising 40% due to unified credits.

### 1.6 Comparative Differences: Australia Vs. India GST Studies

| Aspect            | Greg Smith (2020)                 | T. Vineethan (2024)            |
|-------------------|-----------------------------------|--------------------------------|
| Country           | Australia                         | India                          |
| Level of Analysis | Governmental / federal system     | Business / industry sector     |
| GST Role          | Revenue sharing & fiscal security | Tax reform & performance gains |
| Method            | Legal-economic analysis           | Empirical statistical study    |
| Sector Focus      | Public finance                    | Tourism & services             |

### 1.7 The GST Rate Hierarchy and Public Welfare

The Indian GST system utilizes a five-tier slab structure designed to balance revenue needs with social equity. Essential goods, such as unbranded food items and healthcare services, are placed in the 0% or 5% brackets to protect low-income groups (covering 50% of consumption basket). Conversely, luxury and "sin" goods (e.g., tobacco, high-end motor vehicles) are taxed at the highest rate of 28%, often with additional compensation cesses (e.g., 15% on pan masala). This structure has reduced the effective tax rate from 12.7% pre-GST to 11.6% average, per RBI data.

#### Updated GST Rate Slabs for FY 2025-26:

- **0% (Exempt):** Fresh produce, unbranded grains, salt, and books.
- **5%:** Sugar, spices, edible oils, and life-saving medicines.
- **12%:** Processed foods, mobile phones, and ayurvedic medicines.
- **18% (Standard):** IT services, banking, detergents, and cement.
- **28% (Luxury/Sin):** Luxury cars, tobacco, and aerated drinks.

Recent tweaks, like reducing 12% items to 5% for textiles, aim to curb inflation in essentials amid 6-7% economic growth.

### 1.8 STRUCTURED INCOME TAX SLABS UNDER THE DTC REGIME

The transition toward a DTC-aligned regime emphasizes a progressive but moderate tax structure with fewer deductions. This shift is intended to improve transparency and encourage voluntary compliance, with the new regime (optional since 2020) seeing 70% adoption by salaried taxpayers in AY 2025.

### 1.9 Comparative Analysis: DTC 2009/2010 Vs. DTC 2025

| Aspect     | DTC 2009/2010             | DTC 2025                  |
|------------|---------------------------|---------------------------|
| Approach   | Radical overhaul          | Gradual simplification    |
| Exemptions | Broadly eliminated        | Selectively rationalized  |
| Acceptance | Low (stakeholder revolt)  | High (incremental buy-in) |
| Complexity | Elevated transition risks | Streamlined structure     |
| Litigation | Potential surge           | Marked decline            |

*Note: A 4% Health and Education Cess applies to the total income tax across all slabs.*

### 1.10 Regulatory Frameworks and Financial Governance

Modern tax governance is built upon a foundation of constitutional amendments and legislative acts. In India, the 101st Constitutional Amendment Act (2016) provided the legal basis for GST, establishing a dual administration system where the Center and States jointly manage the tax. It also created Article 246A for concurrent taxing powers.

Governance is further strengthened by the GST Council, chaired by the Union Finance Minister, which facilitates "cooperative federalism" by deciding on rates and procedures (54 meetings held by 2025). In the direct tax sphere, the Central Board of Direct Taxes (CBDT) oversees policy implementation, focusing on faceless assessments and data-driven audits to reduce corruption and discretion—cutting appeal pendency by 30% since 2021.

### 1.11 Digital Compliance: The Backbone of GST 2.0

The current phase of reform, "GST 2.0," signifies a shift from periodic manual filings to continuous, real-time monitoring. The Goods and Services Tax Network (GSTN) serves as the technological engine, integrating e-invoicing and the E-Way Bill system to standardize data and curb evasion (evasion down 40% post-implementation).

### 1.12 Key Digital Reforms (FY 2025-26)

| Security enhancement     | Change  | Details                          | Effective Date |
|--------------------------|---|----------------------------------|----------------|
| 2FA/MFA Portals          | for Required for e-way bills, e-invoices to prevent fraud   | Ongoing online legal India       |                |
| Biometric Authentication | Directors/promoters at GST Suvidha Kendras for registration | March 4, 2025 online legal India |                |

### 1.13 ISD and ITC Rules

| Change                     | Details   | Effective Date                   |
|----------------------------|---|----------------------------------|
| Mandatory ISD Registration | For multiple GSTINs under one PAN; issue ISD invoices, file GSTR-6 for shared services like rent/audits | April 1, 2025 online legal India |

### 1.14 Return Filing Updates

| Form                     | Key Changes                                       | Effective Date                  |
|--------------------------|---|---------------------------------|
| GSTR-7 (TDS)             | Invoice-wise details: GSTIN, amount, tax deducted | Feb 11, 2025 online legal india |
| GSTR-8 (TCS e-commerce)  | Detailed supply reporting for platforms           | Feb 11, 2025 online legal India |
| Sequential Filing GSTR-7 | Includes nil returns for TDS deductors            | Nov 1, 2024 online legal India  |

### 1.15 E-Invoicing and E-Way Bills

| Change                       | Details  | Effective Date                              |
|------------------------------|--|---|
| <b>E-Invoicing Threshold</b> | <b>AATO &gt; Rs. 10 Cr must report B2B invoices to IRP in 30 days or face rejection/ITC issues</b> | <b>April 1, 2025<br/>online legal India</b> |
| <b>E-Way Bill Rules</b>      | <b>Stricter tracking and security measures</b>   | <b>Not specified<br/>online legal India</b> |

### 1.16 Sector-Specific Reforms

| Sector           | Changes   | Effective Date       | GST Rate  |
|------------------|---|----------------------|---|
| <b>Hotels</b>    | <b>Based on actual payment (no declared tariff); full ITC allowed</b> | <b>April 1, 2025</b> | <b>18% if &gt; Rs. 7,500/night<br/>online legal India</b> |
| <b>Used Cars</b> | <b>Uniform on margin value across categories</b>                      | <b>April 1, 2025</b> | <b>18% online legal India</b>                             |

### 1.17 RATE SLABS AND OTHER

| Change                       | Details   |
|------------------------------|---|
| <b>Slab Rationalization</b>  | <b>Most goods to 5%/18%; luxury/sin at 40%; relief for textiles, toys, etc. under Next Gen GST online legal India</b> |
| <b>Registration Timeline</b> | <b>Completes in 3 working days with accurate docs online legal India</b>  |

### 1.18 Input Tax Credit (ITC) Reversal Protocols

To maintain the integrity of the value-added chain, strict rules govern the reversal of wrongly claimed ITC. These protocols ensure that credits are only retained when the underlying transactions meet legal and commercial criteria. Rule 42/43 mandates proportional reversal for

exempt/non-business use, with auto-reversal via GSTR-3B reconciliation; penalties up to 100% apply for fraud, as seen in 2024's ₹50,000 crore ITC scam busts.

### **1.19 Legal Strategies for Dispute Resolution and Anti-Avoidance**

The legal framework increasingly emphasizes Alternative Dispute Resolution (ADR) to minimize the burden on the judiciary (3 crore pending cases overall). Mediation, arbitration, and pre-institution mediation are now prioritized to resolve penalties and compliance breaches faster and at a lower cost—settling 60% of GST disputes via ADR in 2024.

Simultaneously, the General Anti-Avoidance Rule (GAAR), effective since 2017, empowers tax authorities to scrutinize transactions that lack commercial substance (e.g., shell companies for ITC). This is often integrated with residence-based taxation rules, where an individual's global income is taxable if they reside in India for more than 182 days in a year (or 60/365 for RNOR status).

### **1.20 Future Roadmap: Toward GST 3.0 and Full Automation**

The future of Indian taxation lies in "GST 3.0," which envisions single-slab experiments (e.g., revenue-neutral 12% rate pilots) and the potential integration of blockchain for immutable tax ledgers (piloted in Tamil Nadu). The ultimate goal is a fully automated, faceless tax administration where AI-driven analytics perform 90% of refund disbursements and audit selections. This transition focuses on reducing the "cost of doing business" (target: <1% of turnover), transforming tax compliance from a monthly administrative hurdle into a seamless, daily operational function, aligned with Digital India 2047.

### **1.21 Conclusion: Future Outlook of Indian Taxation**

The transformation of India's fiscal landscape marks a move toward a unified, digital-first economy. By replacing the inefficient, cascading pre-GST structure with a streamlined consumption tax and modernizing direct taxes through the upcoming DTC 2025, India has significantly enhanced its ease of doing business.

The shift toward **GST 3.0**—characterized by AI-driven audits and automated compliance—ensures that the system is both equitable and efficient. These reforms provide a stable environment for global investors while protecting essential goods for the common citizen. As India targets a higher tax-to-GDP ratio, the synergy between legislative stability and technological governance will remain the cornerstone of its national growth.

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