Tax Insights & Commentary
Analysis

India's New Tax Act Reshapes the Fiscal Landscape for Businesses

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In a landmark legislative change, the new Income Tax Act, 2025, will replace the six-decade-old Income Tax Act, 1961, effective from Apr. 1, 2026. While its stated goal is simplification, reflected in structural reforms such as reducing the number of sections and unifying the "previous year" and "assessment year" concepts into a single "tax year"—effectively aligning it with the "fiscal year" concept familiar to international taxpayers—the ITA 2025 also introduces some substantive changes. These reforms are set to reshape India's tax landscape by steering in a new era of digital enforcement, enhanced administrative powers, and nuanced interpretations of long-standing tax principles.

Select Committee's Recommendations

After the draft bill for ITA 2025 was introduced in the Lok Sabha (Parliament House of the People) on Feb. 13, 2025, a select committee was appointed to conduct a detailed clause-by-clause examination of the bill. The committee's mandate was to ensure that the new legislation's provisions would be clear, procedurally sound, and fulfill the objective of simplifying the direct tax framework.

The committee's report significantly aided the process of refining the new law. Its recommendations, which preserved taxpayer rights on key issues such as inter-corporate dividends and deductions, were largely incorporated into the final ITA 2025.

Key Changes and Impact

The following are certain key changes that were made under the ITA 2025.

Codification of exclusion of goods and services tax from the asset cost. The ITA 1961, §43(1), defines "actual cost" of an asset as the costs incurred, reduced by any subsidy, grant, or reimbursement. While not explicitly stated in the provision, it was an established principle that if a business claims an input tax credit for the goods and services tax paid on the procurement of a capital asset, the amount of the goods and services tax would be excluded from the asset's cost when calculating depreciation.

The ITA 2025, §39(1), now codifies this established principle that goods and services tax must be excluded from an asset's cost, thereby providing greater certainty.

Potential for interpretational issues that may trigger litigation regarding continuity of ownership test for closely held companies and setting off losses when shareholders change. The ITA 2025 introduces a change to the loss carry-forward provision for closely held companies.

The ITA 1961, §79, stipulates that a closely held company can carry forward and set off its losses in a particular year only if at least 51% of its voting power is held by the same "persons" (plural) who held it in the year the loss was incurred. This meant that a stable *group* of shareholders collectively holding at least 51% voting power would satisfy the continuity of ownership test.

The ITA 2025, §119, replaces the term "*persons*" with "*the person.*" The new singular phrasing could be strictly interpreted by tax authorities to require a *single* beneficial owner to hold a majority stake. This seemingly minor alteration threatens to disqualify companies with consistent collective control from setting off legitimate losses. Although the General Clauses Act, 1897, §13, states that when interpreting legislation, the singular includes the plural, "the person" could be construed as a deliberate change, triggering widespread litigation and penalizing genuine business structures.

Expanded search and seizure procedures to address the digital economy. The scope of search operations under the ITA 1961, §132, as compared with the ITA 2025, is narrower in the context of digital records and only provides for inspection of books of accounts or other documents maintained in the form of an "*electronic record*."

Although the ITA 2025 modernizes enforcement, it also raises significant concerns regarding the fundamental right to privacy. The ITA 2025 significantly enhances the powers of the tax authorities during search operations, as they are now explicitly empowered to access "any information stored in any electronic media or a computer system," which is defined to include a "*virtual digital space*" (email servers, social media accounts, and online trading accounts, cloud servers). ITA 2025, §247, §248, §253, §261(e), (j). The tax authorities may override any access code to gain entry to any computer system or virtual digital space if the taxpayer does not provide the required code. Tax authorities may also inspect and copy data from computer systems and other electronic media.

Reduced procedures for dispute resolution panel. The dispute resolution panel is an alternate dispute resolution mechanism designed to provide a speedier resolution for non-resident taxpayers and taxpayers with transfer pricing cases. Eligible taxpayers may resort to the dispute resolution panel route to resolve disputes at the draft assessment order stage (before a final assessment order is passed) instead of the traditional appellate route which is available only after the final assessment order is passed and is more time-consuming.

While the ITA 1961, §144C, focused on what the DRP must *consider* during the adjudication process (such as the draft assessment order, objections filed by the taxpayer against the draft order, evidence furnished by the taxpayer, etc.), the ITA 2025, §275, dictates what its written directions must *contain*: the points for determination, the decision, and the reasons thereof. This codifies a higher standard for transparency. This is a shift to a result-oriented procedure, requiring the DRP to issue a reasoned order. The directions must now explicitly contain the points for determination, the panel's decision on each point, and the reasoning for that decision, enhancing transparency and accountability.

Broader application of transfer pricing. Under the ITA 1961, §92A, based on current jurisprudence, two enterprises are generally regarded as associated enterprises (AEs), commonly known as related parties, only when both of the following requirements are satisfied:

- general test: participation in management, control, or capital between the enterprises; and
- specific conditions test: at least one specific, objective threshold test is also met, such as one enterprise holding a prescribed minimum shareholding in the other.

In other words, the existence of influence or participation, by itself, is not sufficient; it must be corroborated by meeting at least one clear and measurable deeming condition prescribed in the law.

The ITA 2025, §162, appears to depart from this long-established conjunctive reading. The drafting suggests that the two sets of tests can operate independently. If interpreted literally, this would mean that an enterprise could be treated as an AE of another even if only the broader concept of participation in management, control, or capital exists, without the need to satisfy any specific numerical or objective criteria. Importantly, since participation in management, control, or capital may be quite subjective, this change is likely to lead to protracted litigation.

Potential for interpretational issues of tax treaties that may trigger litigation. The ITA 2025, §162, establishes a hierarchy for interpreting terms used in tax treaties that are not defined therein: first from the ITA 2025, then from a notification by the central government (if any), and finally, from any other central law. The government is empowered to unilaterally define and interpret the terms used in a tax treaty from time to time, and the definitions will be deemed to have been in effect from the date on which the treaty came into force. While the provision provides that a notified definition will apply only if consistent with the broader context and the provisions of the ITA 2025 or the tax treaty, this could lead to interpretational issues and litigation.

Some Missed Opportunities

Ambiguity continues around acquihire transactions. Transactions wherein a company is acquired primarily for the skills and expertise of its employees or staff, popularly known as acquihire transactions, are becoming increasingly common, yet they remain an area of significant tax ambiguity due to the absence of a prescribed framework in the ITA 1961. Although an experienced workforce represents a critical asset for the transferee, the ITA 1961 does not deal with the taxability of such transactions. Despite the rising prevalence of such structures, anticipated legislative changes that could have provided clarity on this issue have not been introduced in the ITA 2025, leaving the uncertainty unresolved.

No tax neutrality for fast-track demergers (ITA 1961, §47(vib), §2(19AA), read with Companies Act, 2013, §233). In India, the concept of demergers is regulated under the Companies Act 2013, with the standard procedure requiring approval of the National Company Law Tribunal. The traditional NCLT route is often time-consuming, requiring compliance with several procedural requirements. To facilitate the ease of doing business, and to provide for a simpler mechanism for corporate restructuring in India, the fast-track demerger process was introduced under §233 of the Companies Act 2013, which allows certain classes of companies to demerge without the lengthy approval process of the NCLT.

While demergers are generally afforded tax neutrality under income tax law, significant ambiguity persists for fast-track demergers introduced under §233 of the Companies Act, 2013. The ITA 1961, §233's definition of "demerger" historically aligns with standard schemes of demerger, now covered by §230 to §232 of the Companies Act, 2013, but omits the separate fast-track provision. Despite the expectations that the ITA 2025 would broaden the definition to include fast-track demergers to provide an impetus to them, ITA 2025, §2(35), explicitly refers only to §230 to §232 of the Companies Act, 2013, leaving out the fast-track demerger-related provision. The recent clarifications from the Ministry of Finance in the submissions to the select committee on the bill cite the absence of judicial oversight (court approval) in fast-track demergers as a key reason for their exclusion from exemption. This confirms that fast-track demergers would not qualify for tax neutrality, forcing taxpayers to carefully weigh the regulatory advantages of this streamlined route against potential tax liabilities.

Future of Indian Taxation

The enactment of the ITA 2025 marks a notable shift toward a more dynamic and digital tax system, demanding proactive adaptation from all stakeholders. For taxpayers and professionals, the immediate priority is to re-evaluate corporate structures—particularly concerning M&A and transfer pricing—in light of new ambiguities. The expansion of search powers into the virtual realm necessitates robust digital record-keeping and a focus on data privacy. Constant vigilance will be crucial to keep pace with an evolving regulatory landscape.

The onus for a smooth transition now rests with the government and the Central Board of Direct Taxes, which must issue timely and unambiguous guidance to mitigate litigation, especially in areas with newfound discretion such as ALP determination. Legislative gaps, such as the tax treatment of acquihires and the inclusion of fast-track demergers, will hopefully be addressed in subsequent finance bills. Ultimately, the success of the ITA 2025 will be measured by its implementation's fairness and efficiency, requiring that enhanced administrative powers be exercised with caution and that taxpayer rights be protected.

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