Budget 2021

DIRECT TAX PROPOSALS

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BUDGET 2021
TAX: TOP HIGHLIGHTS

01
Infrastructure sector investments sweetened for Sovereign Wealth Funds and Pension Funds
GIFT City made more attractive for fund industry and also for aircraft leasing

02
Scope of 'e-commerce supply or services' for the purpose of 2% Equalisation Levy widened retrospectively

03
Noose on M&A restructuring tightened
Slump exchange: Not exempt anymore
Goodwill: Not depreciable anymore -Prospective?
Partnership firms taxable on reconstitution/dissolution

04
Impetus to strategic divestment of public sector companies
Stamp duty value-based tax on sale of residential units rationalised

05
Rules for eliminating double taxation for NRs on foreign retirement funds to be notified

06
A paradigm shift in general limitation period for reopening past tax assessments and other timelines

07
Cashflow & compliance burden for dividends paid to REIT / InvIT addressed
FPIs to enjoy lower withholding tax rates under tax treaties

08
Concrete steps towards effective dispute resolution - Income Tax Dispute Resolution Committee for small taxpayers, Tax Tribunal to go faceless, AAR to be replaced by Board for Advance Rulings to address backlog

09
Sunset for tax holiday for start-ups and capital gains tax exemption on investment in start-ups extended

10
New TDS levy on purchase of goods increases compliance burden
Default in filing tax returns increases TDS/TCS rate

01.

EQUALISATION LEVY – ONE STEP FORWARD, TWO STEPS BACKWARD?

Effective 1 April 2020, a new 2% levy is applicable to the income of offshore digital businesses (2% EL). It is chargeable on consideration receivable by a non-resident "e-commerce operator" for "e-commerce supply or services" provided or facilitated by it to Indian residents, persons using Indian IP address and non-residents in certain cases (subject to satisfaction of certain conditions).

The Bill proposes to further amend the provisions as under:

- The 2% EL will not apply in case of e-commerce supply or services, income from which is taxable as 'royalty' or 'fees for technical services' under the Income-tax Act, 1961 (IT Act) read with the applicable tax treaty;
- The 2% EL will be levied on the entire value of goods / services irrespective of whether the e-commerce operator (such as an e-commerce marketplace) is the owner of goods / provider of services; and
- Scope of "online sale of goods" and "online provision of services" will include any of the following online activities:
  - acceptance of offer for sale;
  - placing or acceptance of purchase order;
  - payment of consideration; or
  - supply of goods or provision of services, partly or wholly.

The clarification about decoupling of 2% EL and 'royalty' / 'fees for technical services' under the IT Act seems more like a correction as royalty / fee for technical services is taxable at 10% and recovering only 2% EL on the same would have resulted in loss of tax revenue. As regards the other amendments, while the industry was expecting rationalisation of the levy, what has come may be disappointing as the 2% EL will apply to the entire consideration for sale / services and will not be restricted to the fee or margin charged by an e-commerce operator. Moreover, merely one activity done online is enough to bring the entire sale / service within the purview of the 2% EL. This could potentially cover sale or services provided offline even if say payment towards the same is made online. For instance, businesses such as foreign hotels or foreign airlines, which allow online bookings by India-based customers, may be liable to pay 2% EL on the consideration received from Indian customers (subject to satisfaction of other conditions for being liable to 2% EL).

These amendments are proposed to be effective from FY 2020-21.

"The pandemic led to a rapid digital expansion of businesses. The equalisation levy with even wider provisions than before may not align too well with the commercial reality of e-commerce business models. These changes would also impact the tax positions already taken by these businesses in the past year. Given the clear stance of the Government on the contours of the levy, the businesses may need to accept this as a cost of doing business in India."

- **Ritu Shaktawat,**
  Partner, Direct Tax

02.

THE DEAL HAS BEEN SWEETENED FOR SOVEREIGN WEALTH FUNDS (SWF) AND PENSION FUNDS (PF)

The Finance Act, 2020 had introduced tax exemption for SWFs / PFs earning dividend, interest and long-term capital gains from investments in infrastructure companies or InvITs or in Cat I / Cat II AIFs having 100% investments in infrastructure sector.

The Bill proposes to expand the scope of this exemption by widening the categories of investees to include:

- Cat I / Cat II AIFs which invest in InvITs. Further, the condition of 100% downstream investment in infrastructure companies by investee Cat I / Cat II AIF has been relaxed to 50%.
- Intermediary holding company, being a domestic company set up and registered on or after 1 April 2021 and having 75% investments in one or more infrastructure companies.
- NBFC- IDF/IFC (non-banking finance company-infrastructure debt fund/Infrastructure finance company) with minimum 90% lending to one or more infrastructure companies.

In the above cases, the exemption will be proportionate to the extent of underlying investment in the infrastructure sector.

In addition to the above, several other amendments are proposed to widen the base of eligible SWF and PF by doing away with restrictions on other commercial activities of SWF, relaxation on use of earnings and assets, etc.

"With the pandemic impact to deal with, the budget is a very positive one with the right impetus for infrastructure and development spend. There is a very promising allocation of funds for key infrastructure sectors like roads and the transport sector. Proposed relaxation of conditions for the tax exemption for pension / sovereign funds is most welcome and will generate a lot of interest in this space. With the budget allocation done the focus should now move to fixing the implementation challenges that mar the infrastructure sector - lessons learnt from successful sectors such as roads (especially around land acquisition and dispute resolution) could pave way for tackling similar issues in other infrastructure sectors."

- **Shivanshu Thaplyal,**
  Partner, Energy, Infrastructure and Resources

These amendments should certainly go a long way in attracting more investments from SWFs and PFs in the infrastructure sector in India.

These amendments are proposed to be effective from FY 2020-21.

03.

NOT JUST "GIFT" – IT'S A LOTTERY!

Currently, the IT Act provides for several tax incentives to units and investors in an International Financial Services Centre (IFSC). The key benefits are (i) tax holiday for ten years; (ii) exempt interest income for non-residents from loans extended to units set up in an IFSC; and (iii) exemption from capital gains tax in relation to transactions in certain securities undertaken on a recognised stock exchange set up in an IFSC.

The Bill proposes the following additional incentives in relation to units set up in IFSCs (subject to fulfilment of prescribed conditions):

- Tax neutral relocation of offshore funds fulfilling prescribed conditions (Offshore Fund) to a fund located in an IFSC and registered as an Alternative Investment Fund (IFSC Fund) and related incentives:
  - Exemption from capital gains tax on the transfer of investments held by the Offshore Fund to the IFSC Fund.
  - Exemption from capital gains tax to the shareholders / unitholders of the Offshore Fund on the transfer of shares / units held in the Offshore Fund in lieu of shares / units in the IFSC Fund, pursuant to relocation.
  - Corresponding exemption from tax on a deeming basis (under Section 56 of the IT Act) on receipt of (i) investments by the Resultant Fund and (ii) shares / units issued by the IFSC Fund to the shareholders / unitholders of the Offshore Fund.
  - No adverse impact for the underlying Indian company under the provisions which result in lapse of past business losses on account of a change in shareholding / voting power of more than 49%, in case of a change in shareholding of such company pursuant to a relocation of its shares.
  - Exemption to a non-resident for capital gains arising on account of transfer of shares of an Indian company by the IFSC Fund, if such shares were transferred to the IFSC Fund on relocation and the capital gains would have not been subject to tax in India, had such relocation not taken place.
- Exemptions in relation to aircraft leasing business:
  - For royalty income of a non-resident from leasing an aircraft to a unit set up in an IFSC (which is eligible for tax holiday in the year in which royalty is paid).
  - For any income arising to an IFSC unit on the transfer of an aircraft or aircraft engine, which prior to such transfer, was leased by the IFSC unit to a domestic company engaged in the business of operation of an aircraft.
- Certain exemptions and reliefs have been extended to investment divisions of offshore banking units located in an IFSC.
- Relaxation of eligibility conditions for an offshore fund having an Indian fund manager not to be considered as (i) having a "business connection" in India or (ii) a resident of India (merely due to the presence of such fund manager in India), where the fund manager is located in an IFSC.
- Exemption to non-residents on the transfer of a non-deliverable forward contract entered into with an offshore banking unit of an IFSC.

These incentives should definitely provide a fillip to the growth of IFSCs in India. The benefits introduced in relation to aircraft leasing business should promote the industry sector in India. Overall, these developments should boost the development of IFSCs in India.

These amendments are proposed to be effective from FY 2021-22.

"GIFT IFSC will boost not only the GIFT city but also the securities market. The opportunity to relocate investments from an offshore fund to an AIF set up in an IFSC, tax free, should incentivise fund houses to set up shop in IFSCs and onshore the fund industry in India."

- **Bijal Ajinkya,** Partner, Direct Tax, Funds and Private Client

04.

WITHHOLDING TAX RATE ON PAYMENTS TO FOREIGN PORTFOLIO INVESTORS (FPIS) RATIONALISED

The income of Foreign Portfolio Investors (FPIs) from securities ie dividend and interest income (except for certain specified interest income which is taxable at 5%) is taxable at 20% (plus surcharge and cess) or a lower rate available under the applicable tax treaty. However, the provision fastening the withholding tax obligation on the payer with respect to such payments to FPIs prescribes 20% as the withholding tax rate and does not consider the tax treaty rates. This resulted in an anomaly as withholding tax could exceed the tax rate otherwise applicable to an FPI as a result of a beneficial tax treaty, leaving the FPIs to claim a refund of the excess tax withheld.

The Bill proposes to resolve this anomaly by amending the withholding tax provisions to provide that tax on dividend and interest payable to FPIs is to be withheld at the lower of 20% (plus surcharge and cess) or the rate provided under a tax treaty, subject to the FPI furnishing its Tax Residency Certificate.

This amendment is proposed to be effective from FY 2021-22.

05.

NO WITHHOLDING TAX ON DISTRIBUTION OF DIVIDEND TO BUSINESS TRUST

Pursuant to the shift in the dividend tax regime by the Finance Act, 2020, dividend receivable by a business trust from a Special Purpose Vehicle (SPV) as defined under the IT Act is taxable in the hands of the unitholders, if such SPV had opted for a concessional corporate tax regime (to offer its income to tax at 22% base tax rate). Consequentially, the business trust is required to withhold tax at 10% on distribution of such dividend income to its unitholders.

There is no carve out for such dividend payments from the general withholding tax provision applicable to companies distributing dividends. Given that the specified dividend income is taxable on a pass-through basis in the hands of the unitholders and not in the hands of the business trust, withholding of tax on dividends by the SPV under the general provision results in cash flow issues and the business trust having to claim a refund of such withholding tax.

The Bill proposes that the SPV will now not be required to withhold tax on distribution of dividend to the business trust. The business trust's obligation to withhold tax on distribution of such dividend to its unitholders remains unchanged.

This is a welcome move and will help in easing the compliance burden on both the SPV and business trust.

This amendment is proposed to be effective from FY 2020-21.

06.

BOOK PROFITS SUBJECT TO MAT

Dividend related anomaly removed for foreign companies

The IT Act provides that Minimum Alternate Tax (MAT) at the rate of 15% of book-profit (to be computed in a prescribed manner) shall be payable in case the tax under normal provisions is less than MAT. For foreign companies, items of income (such as interest, royalty, fees for technical services) are excluded from the ambit of book-profit.

With a view to remove the anomaly for foreign companies on account of the shift in dividend taxation to shareholder level with effect from 1 April 2020, the Bill proposes to provide similar treatment for dividend income and exclude such divided income while computing their book-profit.

This amendment is proposed to be effective from FY 2020-21.

Computation of book profits in cases of advance pricing agreement (APA) / secondary adjustments

The Bill proposes that in cases where income of any past year is included in the accounting profits of a taxpayer on account of an APA or on account of secondary adjustments under the transfer pricing provisions, the tax officer shall, on an application made by the taxpayer, adjust the book profits accordingly.

This amendment is proposed to be effective from FY 2020-21.

07.

IMPETUS TO STRATEGIC DIVESTMENT OF PUBLIC SECTOR COMPANIES

Following measures are proposed to facilitate the divestment of public sector companies:

- Demerger of assets: In general, tax neutral demergers require transfer of an "undertaking". The Bill proposes that any reconstruction or splitting up of a public sector company shall be deemed to be a demerger even if such a reconstruction or splitting up results in a transfer of an asset (not being an undertaking). This remains subject to the resulting company being a public sector company on the appointed date mentioned in the scheme approved by the Government and fulfilling such other conditions as may be prescribed.

- Carry forward of business loss and unabsorbed depreciation: Currently, business loss and unabsorbed depreciation of amalgamating companies can be carried forward in the hands of the amalgamated company upon fulfillment of certain conditions. The Budget proposes to extend this benefit to:

  – Amalgamating public sector company(ies) which merge with another public sector company (ies); and

  – Erstwhile public sector companies which merge with another company upon fulfillment of conditions.

These amendments are proposed to be effective from FY 2020-21.

08.

'SLUMP EXCHANGE' | NO MORE TAX EXEMPT

The IT Act contains special provisions for taxation of capital gains on "slump sale" involving sale of a business/undertaking for a lump sum price.

Courts in certain rulings have held that these special provisions should apply only to a "sale" of business ie transfer for a monetary consideration, and should not cover other modes of transfer of business such as an "exchange" ie transfer for a non-monetary consideration.

The Bill proposes to correct this anomaly by clarifying that the meaning of "slump sale" includes the transfer of a business undertaking by any means (for a lump sum consideration) as against only by way of a "sale".

This proposal clarifies that all modes of business transfer are covered within the ambit of "slump sale". and is aligned with the Government's stance of "substance" over "form" based taxation.

These amendments are proposed to be effective from FY 2020-21.

09.

GOODWILL | NO MORE DEPRECIABLE

Currently, while the IT Act provides for depreciation on intangible assets including know-how, patents, copyrights, trademark, licences, franchises or any other business or commercial rights of similar nature, it does not specifically refer to goodwill. In this context, the Supreme Court of India has held that goodwill is an intangible asset eligible for depreciation.

The Bill, however, clarifies that goodwill cannot be regarded as a depreciable asset and accordingly proposes that:

- The block of assets (which essentially includes depreciable assets) and intangible assets which qualify for depreciation shall exclude goodwill of a business or profession.

"This budget could really kick start the slowing economy. All the bells and whistles seem to be in place. Much needed push to our failing infrastructure, divestments of PSUs, focus on clean up of stressed assets, monetising locked up infra under ports, airports etc, and lastly a DFI! This is the budget we needed for this new decade. Kudos!"

- **Divaspati Singh,** Partner, Funds and Corporate Law

"From an M&A perspective, withdrawing benefit of depreciation on goodwill will surely require a relook at deal dynamics especially the intangible driven ones. This neutralizes the position laid down by the Hon'ble SC that goodwill is eligible for depreciation."

- **Vinita Krishnan,** Director, Direct Tax

"Strategic disinvestment of two public sector banks is a welcome move and would help raise much needed capital for meeting capitalisation requirement for public sector banks which are required to be supported by the Government."

- **Kumar Saurabh Singh,** Partner, Banking

- No depreciation shall be allowed with effect from 1 April 2020 on goodwill purchased on or after 1 April 2020 as well as for goodwill existing in the block of assets of a taxpayer as on 1 April 2020.

- A mechanism shall be prescribed to compute short term capital gains on transfer of assets forming part of the block of assets, which includes goodwill as on 1 April 2020 and on which depreciation has been claimed.

- The cost of acquisition for goodwill:

  - purchased by the taxpayer shall be equivalent to the purchase price;

  - acquired under business re-organisation and certain other specified modes shall be equivalent to the purchase price in the hands of previous owner; and

  - in other cases, such as self-generated, shall be nil.

It is also proposed that where depreciation has been claimed on goodwill at any time up to FY 2019-20, such depreciation shall be reduced from the purchase price of goodwill.

While this proposal once enacted will end the long-drawn controversy on claims of depreciation on goodwill, it will have an impact on mergers, demergers and business acquisitions where part of the consideration is allocated towards goodwill. The impact of this provision on cases where depreciation has been claimed and allowed in the past will need to be evaluated. Further, the exact manner to (i) carry out adjustments to the tax written down value of the block of assets as on 1 April 2020 (which includes goodwill); and (ii) compute capital gains on transfer of assets falling within the said block, will need to be evaluated basis the mechanism to be prescribed.

This amendment is proposed to be effective from FY 2020-21.

10.

TAX ON PARTNERSHIP FIRM ON RECONSTITUTION/DISSOLUTION

Currently, any distribution of capital assets by a firm to its partners upon its dissolution or otherwise, is taxed as capital gains in the hands of firm. The applicability of this provision is however unclear in situations when a firm revalues its assets or records any self-generated asset in its books of accounts and pays its partners an amount exceeding their capital contribution.

The Bill proposes to replace the abovementioned provision and levy a capital gains tax on the partnership firm in the following cases:

- Receipt of capital asset by partner upto partner's capital contribution upon dissolution/reconstitution of the firm: On the difference between the fair market value of the capital asset and the cost of acquisition of such asset.

- Receipt of cash/ other asset by the partner exceeding partner's capital contribution upon dissolution/reconstitution of the firm: On the difference between the value of money/ fair market value of asset and the balance in the capital account.

Any increase in the capital account of the partners due to revaluation of any asset or due to self-generated goodwill (or any other asset) shall be excluded while computing the capital contribution balance.

These amendments dilute the flexibility otherwise available to partners in planning their tax affairs at the time of admission, retirement and dissolution.

The above provisions are also applicable to Association of Persons (AOPs), Body of Individuals (BOIs) and their members.

These amendments are proposed to be effective from FY 2020-21.

11.

BIG BROTHER APPROACH - TAX TO BE WITHHELD EVEN ON PURCHASE OF GOODS!

The previous budget introduced tax collection at source (TCS) provisions whereby a seller of goods was to collect tax at the rate of 0.1%, over and above the consideration, from the buyer. TCS was not applicable where the buyer withheld taxes from the payment of purchase price.

On the same lines, the Bill proposes to levy an obligation on the buyer of goods to withhold tax at the rate of 0.1% when buying goods from an Indian resident. The withholding obligation only exists where the consideration for goods exceeds

INR 5 Million and the buyer had a business turnover of more than INR 100 Million in the immediately preceding year. Such provisions are added as big-brother measures to have all material transactions reported effectively. Further, the withholding tax rate is proposed to be increased to 5% where the seller does not have a Permanent Account Number (PAN), an unlikely scenario in case of resident sellers transacting in high value transactions.

While the seller would not be required to collect TCS where the buyer withholds taxes, the proposed amendment will increase compliance burden for the buyer, especially non-resident buyers not having any business in India. It is also debatable whether the withholding tax provisions can apply to a non-resident not having any Indian presence, on payment made to an Indian resident. Where the non-resident is withholding taxes, such non-resident would have to procure Indian tax registration such as PAN and Tax Deduction Number (TAN). Further, the term 'goods' has not been defined and hence, applicability of withholding tax will need to be evaluated for each transaction.

This amendment is proposed to be effective from 1 July 2021.

12.

PAST DEFAULT INCREASES FUTURE TAXES!

Currently, the withholding tax rate is bumped up to 20% (from an otherwise lower prescribed rate),if the recipient does not have a PAN (subject to certain exceptions). Similarly, the TCS rate is bumped up to 5%, where the payer does not have a PAN.

The Bill proposes to include new provisions to monitor and enforce compliance with tax return filings which will result in a higher withholding tax rate and TCS rate, where the payee and payer have respectively defaulted in filing income tax returns for the two immediately preceding years. This provision will only apply where the withholding tax or TCS levied on such payee or payer (as the case may be) was more than INR 50,000 in each of the two such preceding years. The bumped-up tax rate would be:

In case of withholding tax rates, the higher of:

- twice the rate provided under the IT Act; or
- twice the rate or rates in force (ie treaty rates in some cases); or
- the rate of 5%.

In case of TCS rates, the higher of:

- twice the rate provided under the IT Act; or
- the rate of 5%.

An immunity has been provided to certain payments from such enhanced tax, including payment of salaries, payment of rent by individuals and HUFs, winnings from a lottery or crossword puzzle, winnings from horse races, distribution of income to investors of securitisation trusts, payment in cash by banks, co-operative societies or post offices. Further, the enhanced rate of withholding tax, in the absence of PAN, would remain at 20% for payments made to non-residents that do not have a permanent establishment in India (unless certain prescribed alternate information/ documents are furnished). Similarly, the TCS rate would remain at 0.1% for such non-residents, in the absence of PAN, not having a permanent establishment in India.

These amendments are proposed to be effective from 1 July 2021.

13.

FILLIP TO REAL ESTATE DEVELOPERS AND HOME BUYERS

Currently, for transactions involving sale of immovable property (land, building or both) not held as capital assets, the IT Act provides for charge of tax on actual consideration or the stamp duty value (ie circle rate) of the immovable property deemed as sale consideration for computing business income on such sale. The deeming provision is attracted if 110% of the actual consideration is less than the stamp duty value. Separately, the buyer is also taxed on such difference (if it exceeds INR 50,000) under the head 'income from other sources'.

As part of the Atma Nirbhar Bharat Package 3.0 announced by the Finance Minister on 12 November 2020, relief from the deemed tax (to both sellers and buyers) was provided up to 120% of the actual consideration on certain specified category of 'residential units' and on fulfillment of the following conditions:

"With real estate prices having fallen below the stamp duty rates in certain areas, the proposed amendment is positive, both for real estate developers as well as the buyers, and could provide a much-needed boost to the real estate sector in tackling its liquidity concerns in the face of the pandemic induced slowdown. This relief coupled with reduced stamp duty rates in certain jurisdictions as well as low interest rates on home loans have resulted in record real estate sales in the past few months and this trend is likely to continue."

– **Ashish Mehta**, Partner, Direct Tax and Direct Tax Litigation

- The transfer of the 'residential unit' takes place during the period 12 November 2020 to 30 June 2021.
- The transfer is by way of primary (first time) allotment of the 'residential unit' to any person (ie, first sale from builder).
- The consideration received or accruing from such transfer of 'residential unit' does not exceed INR 20 Million.

The Bill proposes to amend the relevant provisions of the IT Act to give effect to the aforesaid relief. 'Residential unit' has also been defined in the proposed provision.

These amendments are proposed to be effective from FY 2020-21.

14.

EXTENSION OF INCENTIVE FOR AFFORDABLE HOUSING PROJECTS

Currently, the IT Act provides for a deduction of 100% of the profits derived by a taxpayer from the business of developing and building affordable housing projects; provided that, the project is approved by the competent authority by 31 March 2021.

In order to promote development of affordable housing and aid migrant workers, especially in light of the pandemic, the Bill proposes to:

- Extend the outer date for obtaining approval for affordable housing projects from 31 March 2021 to 31 March 2022.
- Extend this deduction to approved 'rental housing projects' as well, which shall be notified by the Government by 31 March 2022 (subject to certain conditions).

These amendments are in line with the vision of the Government to provide housing for all, to support the real-estate sector and to provide employment to displaced migrants in these otherwise testing times.

These amendments are proposed to be effective from FY 2021-22.

15.

START-UPS

100% profits deduction extended to start-ups set up by 31 March 2022

Currently, a start-up incorporated between 1 April 2016 to 31 March 2021 and meeting certain conditions, is eligible for a deduction of 100% profits derived from an 'eligible business' for 3 consecutive FYs out of its initial 10 FYs, at the option of the start-up.

The Bill proposes to extend the outer date for incorporation of eligible start-ups from 31 March 2021 to 31 March 2022.

This amendment is proposed to be effective from FY 2021-22.

Capital gains tax exemption on account of investment in eligible start-ups extended till 31 March 2022

Currently, capital gains earned by certain eligible taxpayers from the transfer of long-term residential property are exempt, provided that, the net sales proceeds are utilised to subscribe to equity shares of an 'eligible start-up' which in turn utilises the amount to purchase a 'specified new asset' within a year from the date of subscription by the taxpayer.

The exemption is currently available only if the long-term residential property is transferred on or before 31 March 2021.

The Bill proposes to extend the outer date for transfer of residential property from 31 March 2021 to 31 March 2022.

This amendment is proposed to be effective from FY 2021-22.

"A much needed boost has been given to the start-up environment by extension of time to qualify as a start-up for the purposes of tax holiday. Further, extension of time limit to qualify for capital gains tax exemption by investing into start-ups would see more capital being made available by the first time investors to the start-ups. It is hoped that the government considers extending such time limits indefinitely, in the coming years, to have a sustainable support mechanism around start-ups"

- **Indruj Rai,** Partner, Direct Tax

The above proposals will continue to stimulate the start-up industry spurring innovation, employment and ultimately economic growth.

16.

OTHER KEY PROPOSALS

Residency | Defining 'liable to tax'

Currently, the IT Act uses the phrase 'liable to tax' in several instances - importantly, in tax residency rules and tax treaties – without defining the phrase. Differing judicial interpretations have confused the understanding of what 'liable to tax' connotes.

The Bill proposes to define the phrase whereby 'liable to tax' in relation to a person means that there is a liability of tax on that person under the applicable law of any country and includes a case where after the imposition of such tax liability, an exemption has been provided.

The determination of 'liable to tax' (as opposed to the construct of 'subject to tax') is often significant to conclude the tax residence of the person or to determine the tax applicable to an entity. Specifically, the phrase has been used while ascertaining tax liability of an Indian citizen who is 'stateless' or not resident in any country (under Section 6(1A) of the IT Act, a recent but significant change made when taxing individuals) and to resolve instances of double taxation. It is helpful that the definition is in line with the international understanding of the phrase, particularly since tax treaties in some cases rely on domestic law for interpretation.

This amendment is proposed to be effective from FY 2020-21.

Addressing mismatch in taxation of income from overseas retirement fund

Currently, withdrawals made by non-resident Indians (NRIs) from overseas retirement funds are usually taxed on a receipt basis (ie when funds are actually received or paid) in foreign countries but on accrual basis (ie when income is earned regardless of when funds are actually received) in India.

The Bill proposes to introduce a new provision to address this mismatch whereby a 'specified person' who has income from a 'specified account' shall be taxed in the manner and year as prescribed. A 'specified person' is an Indian tax resident who opened a specified account whilst being a resident in the notified country and a non-resident of India. A 'specified account' is an account maintained by the specified person in a notified country in respect of retirement benefits, where the account's income is taxed by that country not on an accrual basis but at the time of withdrawal or redemption. The Government may notify countries for the purposes of availing this beneficial provision.

This is a 'mini' shot in the arm for the NRI community since it is intended to address a genuine hardship faced by many NRIs desirous of returning to and retiring in India. In terms of the financial year, India follows the 1 April – 31 March period while many other countries (such as the United States of America) follow the calendar year period. This difference in taxation periods often leads to double taxation of income and creates difficulties in obtaining credit in foreign jurisdictions for Indian taxes paid on an accrual basis. It is expected that the introduction of this provision shall ameliorate these issues. Further, the amendment is in line with the Government's policy of providing a warm welcome to NRIs and incentivising their return. It should be noted that the rules framed in respect of this provision will be crucial since the section itself contains little details.

This amendment is proposed to be effective from FY 2021-22.

Deposit the employee contributions in time or bid adieu to tax deductions!

As per the IT Act, any sum received by an employer from its employees as contribution to specified funds such as a provident fund or a superannuation fund, which is subject to deposit of such contribution on or before the due date specified in the respective legislation, can be claimed as a tax deductible expenditure by the

"As per the recently amended individual residency rules, a citizen of India is considered as a resident of India if, amongst other conditions, not liable to tax in any country. The amendment did court controversy when the term 'liable to tax' was undefined and left to be interpreted by judiciary, as and when the tax authorities and taxpayer litigate on this point. It is commendable that to side-step this eventuality and to avoid litigation, the Government deemed fit to import the definition of 'liable to tax' in the statute books. Further, the proposed definition is in line with the international commentaries and Indian jurisprudence."

- Shabnam Shaikh, Partner, Direct Tax, Private Client and Equity Incentives

"All roads lead to India? The proposal to ease the pain for NRIs who face administrative challenges arising from double taxation of income in their foreign retirement accounts is a small but helpful step. Rules (sought to be announced) should hopefully address the mismatch in the taxation period and simplify the process of availing credit for doubly taxed income."

- **Aditi Sharma,** Partner, Direct Tax and Private Client employer. Similarly, the employer could also claim its contribution into specified funds as a tax deductible expenditure, provided it deposited the same on or before due date for filing the tax return.

Various courts have interpreted these provisions liberally and allowed the claim of deduction of an employee's contribution to the employer even if the same was deposited by the employer after the fund's due date but before the due date for filing the tax return ie, on par with the employer's contribution.

The Bill proposes to clarify this stance and provides that deduction for an employee's contribution will be allowed to the employer only if it is deposited on or before the fund's due date.

While this amendment is proposed to be effective from FY 2020-21 and onwards, the amendment states that it is clarificatory in nature and the provisions dealing with tax deduction claimed by the employer for contributing towards recognised funds were never sought to be applied to a tax deduction claim in relation to an employee's contribution. Thus, this proposed amendment is likely to affect the position adopted by taxpayers in prior years.

Pay as you earn!

Under the IT Act, taxpayers are to pay tax on an advance basis by estimating the current year's income. Any shortfall in or failure to pay advance tax instalments results in the levy of interest. However, interest is not levied where the shortfall or non-payment is due to under-estimation of or failure to estimate certain kinds of income (capital gains, winning from lotteries, etc), provided tax is paid in instalments subsequent to the actual earning of the income.

The immunity from interest is proposed to be extended to dividend income in the hands of the shareholders as it is understandable that dividends may not be estimated with a degree of certainty. Of course, tax would have to be paid in instalments subsequent to the actual earning of the dividend income. Also, the exemption is not granted to deemed dividend income on account of loans granted by companies to shareholders or any payment by companies on behalf or for the benefit of shareholders.

The proposed amendment is a welcome move and will help in reducing tax costs for the taxpayers.

This amendment is proposed to be made effective from FY 2020-21.

Tightening the noose on Charitable Institutions

Currently, any voluntary contributions received by a duly registered charitable trust or institution do not form part of its income, if they are made with a specific direction that they shall form part of the corpus of the trust or institution. Further, the provisions of the IT Act are silent on how such corpus donations should be dealt with.

The Bill proposes to make the exemption stricter by providing that such corpus donations should be deposited in one or more of the forms or modes specified under Section 11(5) of the IT Act and maintained specifically for such corpus.

To be able to avail the tax exemption, charitable trusts and institutions are required to apply at least 85% of their income towards charitable purposes in India every year. With respect to this, the Bill also provides that any such application out of the corpus of a charitable trust or institution or from a loan or borrowing shall not be considered as an application of income for charitable purposes.

This has been provided to address situations of double deductions, for instance, where the application from the corpus is claimed as an application of income while the corpus donation is also claimed as exempt income. Similarly, the amendment seeks to avoid a situation where the application threshold is first satisfied by applying amounts received as loans and borrowings and its repayment is also claimed as application. The proposed amendment provides that only at the time of repayment of loan shall the amount be treated as an application of income.

These amendments are proposed to be effective from FY 2021-22.

Relief to senior citizens from filing income-tax return

Currently, the IT Act mandates filing of income-tax return for individuals whose taxable income exceeds specified thresholds (INR 0.3 Million for individuals of 60 years or above and INR 0.5 Million for individuals of age 80 years or above).

The Bill proposes to relax the tax filing requirement provided to a senior citizen who is of the age of 75 years or more so long as such individual has only pension income and interest income from the same bank in which the pension income was received. Such a senior citizen would also be required to file a declaration with the said bank providing requisite details as prescribed.

While the senior citizen who qualifies is exempt from filing an income-tax return, the bank would

"Delayed deposit of employee provident fund contribution by employers will lead to deduction not being available for employers. This will benefit the employees and ensure more timely compliance by employers and protect employees' interests."

- **Bhavik Narsana,** Partner, M&A and Corporate Law practice group still be obligated to deduct applicable withholding tax on interest paid by it to the senior citizen. Accordingly, the onus of payment of taxes by such senior citizen has been shifted on the banks. While this is a well-intentioned proposal to reduce compliance burden for senior citizens, only some members with limited income streams may qualify for the benefit.

This amendment is proposed to be effective from FY 2021-22.

Rush Hour: Reduction in timelines to file belated and revised tax returns

Currently, the IT Act allows the filing of belated and revised income-tax returns before the completion of a tax assessment within the statutorily provided timeline or up to the end of the assessment year, ie, up to 12 months from the end of the FY, whichever is earlier. Currently, the IT Act provides a minimum time period of 24 months from the end of the FY for completion of tax assessments.

The Bill proposes to reduce the above period of 12 months to 9 months from the end of the FY.

These amendments are proposed to be effective from FY 2020-21.

"Reducing time lime for reopening of completed tax assessments from present 6 years from the end of relevant tax assessment year to 3 years is positive from the perspective of certainty. This is also in line with what Hon'ble Supreme Court had observed in famous Vodafone Tax ruling of 2012 that certainty in tax matters is of paramount importance for taxpayers community and to promote conducive business and foreign investment environment in the country"

- **Sanjay Sanghvi,** Partner, Direct Tax and Direct Tax Litigation

17.

DISPUTE RESOLUTION

Fast tracking assessment timelines

With a view to reduce the time gap between filing of tax returns and completion of assessments thereof, the Bill proposes the following amendments:

Summary assessment: Currently, intimations under Section 143(1) of the IT Act cannot be issued beyond a period of 12 months from the end of the relevant FY. The Bill proposes to reduce this time limit to 9 months from the end of the relevant FY.

Selection of cases for scrutiny assessment: Currently, the time limit to issue notice for selection of a case for scrutiny assessment proceedings under Section 143(2) of the IT Act is 6 months from the end of the relevant FY in which the income-tax return is filed. The Bill proposes to reduce this time limit to 3 months from the end of the relevant FY in which the income-tax return is filed.

Completion of scrutiny assessment proceedings: Currently, scrutiny assessment proceedings are required to be completed within a period of 24 months from the end of the relevant FY. The Bill proposes to reduce this time limit to 18 months from the end of the relevant FY. This amendment is proposed to be effective from FY 2020-21.

Paradigm shift in reopening of assessments

Currently, the IT Act provides for reopening of past tax assessments (17 years from the end of relevant FY in case of foreign assets and 5 or 7 years (depending upon quantum of income) from the end of relevant FY in other cases) if *inter alia* the tax officer has 'reasons to believe' that income has escaped assessment. For this purpose, the tax officer is required to follow a set procedure (record reasons for reopening, issue reopening notice, dispose of taxpayers' objection, etc.).

The Bill proposes to do away with the aforesaid scenarios and provides that tax assessments cannot be reopened beyond 4 years from the end of the relevant FY. However, if the tax officer has material in his possession that income (represented as an asset) chargeable to tax has escaped assessment and amounts to or is likely amount to INR 5 Million or more for that year, tax assessments can be reopened within 11 years from the end of the relevant FY.

This is a paradigm shift in relation to the number of years for which past tax assessments can be reopened. Further, the longer time limit available to reopen past 17 years assessment in cases relating to 'foreign assets' has been done away with (limiting the overall look back period to 11 years from the end of the relevant FY). Further, the Bill proposes to move from the test that *"the tax officer should have 'reasons to believe' that income has escaped assessment"* to the test that *"the tax officer should have 'information' which 'suggests' that income has escaped assessment"*. This appears to be a lower threshold and one will need to wait and watch how the earlier arguments against reassessment proceedings like change of opinion, full disclosure on part of taxpayers, etc. are dealt with in this new regime.

It is further proposed that in search, survey or requisition cases initiated or made or conducted, on or after 1 April 2021, the tax officer shall be deemed to have 'information' which suggests that the income chargeable to tax has escaped assessment and hence cases will follow the newly proposed reassessment route and procedures and not search assessment route as is presently the case. The rationale mentioned for merging search assessment provisions and procedures to reopening is that the earlier block proceedings as well as present search assessment related provisions have failed. In search cases, various courts (including the Supreme Court of India), have held that if no incriminating material is found, the search fails and thus no adjustments can be made in such search assessments. The proposed amendment will have the effect of indirectly addressing this issue in favour of the tax authorities.

Authority for Advance Rulings to be replaced by the Board for Advance Rulings

The IT Act contains a scheme of advance rulings by the Authority for Advance Rulings (AAR) constituted with a view to avoid disputes with respect to assessment of tax liability and provide tax certainty. It has the following salient features:

- The rulings pronounced by AAR are binding on the applicant & tax department (the applicant can however challenge rulings by way a writ petition before the High Court).
- The AAR is required to pronounce its advance ruling within 6 months of the receipt of the application.
- An AAR bench consists of the Chairman / Vice-Chairman, Revenue Member and Law Member, who must meet the prescribed eligibility criteria. However, on account of non-availability of eligible persons, the posts of Chairman and Vice Chairman have remained vacant for some time resulting in a significant backlog.

The Bill proposes that:

- The AAR shall cease to operate with effect from a date to be notified by the Government.
- A new forum, to be called the Board for Advance Rulings (Board) shall be constituted to provide advance rulings.
- The Board shall consist of 2 members (not below the rank of Chief Commissioner).
- The aggrieved party (whether the taxpayer or the tax department) may file an appeal before the High Court to challenge a ruling pronounced by the Board.
- Applications which are pending before the AAR shall stand transferred to the Board.

The replacement of the AAR with the Board seeks to tackle the backlog and provide for the right to appeal against such advance rulings.

This amendment is proposed to be effective from FY 2021-22.

Tax Tribunal to go 'faceless'

Currently, proceedings before the Income Tax Appellate Tribunal (ITAT) are conducted physically as well as electronically (on account of the pandemic).

The Bill proposes to introduce a faceless scheme for all ITAT hearings and constitution of a National Faceless Income Tax Appellate Tribunal Centre.

This is one more step by the Government towards digitising the entire tax administration system in India with the Faceless Assessment Scheme, 2019, Faceless Appeal Scheme, 2020 and Faceless Penalty Scheme, 2020 already in force; and will have a huge impact on the way income tax appeals will be adjudicated going forward. Key aspects of the faceless scheme are:

- Eliminating interface between the ITAT and parties to the appeal in the course of appellate proceedings. Personal hearings if requested for, will also be through video conferencing.
- Optimising utilisation of the resources as well as equal distribution of work: There were several administrative constraints in the functioning of benches in smaller cities as members of the ITAT would have to travel for hearings. The use of technology is expected to eliminate such administrative issues, ensure better and effective administration of appeals, equal distribution of workload and also bring down the pendency of appeals.
- An appellate system with dynamic jurisdiction to impart greater efficiency, transparency and accountability.

This amendment is proposed to be effective from FY 2021-22.

"Extending faceless appeals mechanism till the Tribunal level - A smart move or a lost opportunity for the taxpayer to claim himself before the last fact finding income tax authority? It would depend upon the assurance to have a personal hearing for effective representation by the taxpayer, on taxpayer's option, albeit through video calls.

- **Indruj Rai,** Partner, Direct Tax

Dissolution of the Income-tax Settlement Commission

Currently, the IT Act provides for an alternative dispute resolution mechanism through an Income-tax Settlement Commission (ITSC) which is a quasi-judicial body empowered to waive penalty and prosecution in cases that are successfully settled.

The Bill proposes to dissolve the ITSC, cease its operations and substitute it with an Interim Board for disposing off pending cases. The Bill proposes to make the following amendments in this regard:

- ITSC shall cease to operate from 1 February 2021 and no fresh applications will be allowed.
- The Government has been empowered to constitute one or more Interim Boards which will consist of 3 members each having the rank of Chief Commissioner.
- On dissolution of ITSC, all pending applications will be handled by the Interim Board.
- In relation to pending applications, the applicant will have an option to withdraw such application within a period of 3 months from the date of commencement of the Finance Act, 2021, after intimating the tax officer about such withdrawal in the prescribed manner, failing which the application shall deemed to have been received by the Interim Board.
- In the event that the applicant decides to withdraw the application, there are specific provisions dealing with the same.
- The Interim Board shall be conferred with the same duties and powers as that of the ITSC.
- Further, the Government has been also empowered to make a faceless scheme in respect of settlement of pending applications before the Interim Board.

These amendments are proposed to be effective from 1 February 2021.

Resolution of tax disputes through Dispute Resolution Committee

The Bill proposes to constitute a Dispute Resolution Committee (DRC) to provide tax certainty to small taxpayers and for resolution of their tax disputes at an initial stage. Key features of the DRC are as follows:

- One or more DRCs may be constituted to resolve disputes as will be prescribed. The taxpayers (who meet conditions as may be prescribed) will have an option to opt for or not opt for dispute resolution through DRC mechanism.
- Only those disputes where the returned income is INR 5 Million or less (if tax return has been filed) and the aggregate amount of variation proposed in the specified order is INR 1 Million or less will be eligible for resolution by the DRC.
- Taxpayers in whose case a specified order has been passed based on a search and seizure, income-tax survey or information received from foreign jurisdictions under any information sharing agreement will not be eligible for resolution by the DRC.
- Taxpayers facing prosecution or those convicted under various laws will not be eligible.
- The DRC, subject to such conditions as may be prescribed, shall have the powers to reduce or waive any penalty imposable under the IT Act or grant immunity from prosecution for any offence under the IT Act for taxpayers opting for DRC route.
- The Government has also been empowered to make a faceless scheme for resolution of tax dispute by the DRC.

The intent behind the proposed amendment is to resolve disputes at the initial stages and prevent further litigation, thus reducing the burden on the appellate authorities. While the threshold amounts for eligibility for opting for this scheme are small, this could well be a pilot project. If all goes well, one hopes this option will be extended to larger tax litigation matters as well, as such settlement options are available in a number of other jurisdictions globally.

This amendment is proposed to be effective from FY 2021-22.

– *KCO | Direct Tax Team*

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