Budget 2022

DIRECT TAX PROPOSALS

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BUDGET 2022
TOP HIGHLIGHTS

1. Government's capital expenditure outlay increased by 35% to INR 7.5 lakh crore for FY 23

2. Major Infrastructure push – focus on highway construction, development of ropeways, cargo terminals, data centres;
Boost for renewable energy - Additional allocation of INR 19,500 cr for PLI in solar module manufacturing

3. Sovereign Green Bonds to be issued in FY23 to help mobilise resources for green projects

4. Digital Rupee – Digital Currency using blockchain technology to be issued by RBI in FY23

5. Cryptocurrency specific tax measures – Transfer of virtual digital assets, including cryptocurrencies and NFTs, to be taxed at 30%, TDS at 1%; no deductions allowed, loss from such transfer cannot be set off or carried forward

6. MSME Push – Impetus to startups focusing on technology in agriculture and drone manufacturing/ services, Emergency Credit Line Guarantee scheme for MSMEs extended, Incorporation deadline for tax incentives extended for startups

7. IBC – Necessary amendments to be carried out to facilitate cross-border resolutions; for tax purposes, status of taxpayer's demand to be modified in line with the order passed by the authorities under the IBC law.

8. GIFT City – International Arbitration Centre to be set up; Top global universities to be allowed to set up courses in financial management, fintech, science, technology, engineering and mathematics; additional tax sops announced

9. Updated tax return: option to correct the tax returns or take benefit of the extended time frame for undertaking the compliance by paying additional taxes

10. Bolstering Investment – Surcharge on all long-term capital gains capped at 15%; Government to form an expert committee to help scale up and facilitate PE and VC investments

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01.

TAX RATES

Base Rates

The Finance Bill, 2022 (Bill) has not proposed any changes in the base tax rates and the income slabs under the Income-tax Act, 1961 (Tax Act). The rates are listed in the table below for ready reference:

Taxpayer	Tax rates
Domestic companies	15% / 22% / 25% / 30%, depending on factors such as nature of business, commencement of operations, turnover in Financial Year (FY) 2020-21, optional concessional tax regime, etc
Foreign companies	Corporate tax rate of 40% (special rates for specified income streams)
Partnerships & LLPs	30%
Individual/Hindu Undivided Families (HUFs)/ Association of persons (AOPs)	Progressive slab rates

Surcharge on Base Rates

While the surcharge rates have remained the same for all taxpayers, they have been capped in the following cases:

- Individuals / HUFs/AOPs: The maximum surcharge rate for individuals, HUFs and AOPs on any long-term capital gains (LTCG) to be capped at 15% and the current rates of surcharge of 25% and 37% on income exceeding INR 2 Crores and INR 5 Crores respectively would not be applicable.

  Currently, in case of capital gains, the said cap of 15% surcharge is restricted only to LTCG from the transfer of listed shares on a recognised stock exchange (subject to certain conditions). This amendment will bring down the maximum effective tax rate on LTCG on the sale of assets such as unlisted shares, listed shares in off-market transactions, immovable properties etc. For instance, in the case of transfer of immovable properties by resident and non-residents, the maximum effective tax rate on LTCG would reduce from 28.5% to 23.92% respectively and in the case of share sales, the maximum effective tax rate on LTCG would reduce from 28.5% to 23.92% for residents and 14.25% to 11.96% for non-residents.

- AOPs: The maximum surcharge rate to be reduced from the existing 37% to 15% for AOPs which consist of only companies as members.

Dividends received from Foreign Companies

To ensure consistency with the prevailing dividend taxation regime and parity between domestic and offshore dividends, dividends received by an Indian company from a specified foreign company (in which the Indian company holds at least 26% shares) would be subject to applicable corporate rates and the concessional tax rate of 15%, currently applicable, would be done away with.

02.

SPECIFIC REGIME FOR TAXATION OF VIRTUAL DIGITAL ASSETS (VDAs)

The most awaited tax proposals specific to taxation of VDAs have been announced for the first time, as discussed below:

- The Bill defines VDAs broadly to cover *inter alia* (a) any information, code, number or token generated through cryptographic means or otherwise; (b) to be notified non-fungible tokens; or (c) other to be notified digital assets. Given the wide definition, it needs to be examined whether assets or benefits like digital gift cards, loyalty or cashback points on cards and similar assets could be covered here.

- The income arising from transfer of VDAs taxable at 30% (plus applicable surcharge and cess).

- Except for the cost incurred in acquiring the VDAs, no deduction of expenses or set-off of any loss available against the income arising from transfer of the VDAs.

- Any losses arising on transfer of the VDAs not available to be set-off against any other income.

- The receipt of VDAs by a person for nil or inadequate consideration, taxable in the hands of the recipient, unless it falls within the list of specified exceptions (such as receipts from relatives). However, in the absence of any specific valuation rules, there is lack of clarity on the manner of valuation of VDAs for this purpose. The government may address this in due course.

- Persons making payments to Indian residents towards the transfer of a VDA, to withhold tax at 1% on such sum. Where tax is withheld, any other provision requiring tax withholding or collection is not attracted. In the case of payments to non-residents, no special withholding tax rate is prescribed (the general principles of taxability subject to situs/source rules and consequent withholding would be relevant).

- If the consideration payable is wholly or partly non-cash, then the payer must ensure that tax is paid in respect of such transaction, before paying the consideration. From a withholding tax compliance perspective, there may be certain practical challenges such as payment of tax when consideration is in kind, and the availability of details regarding identity/tax residence of sellers, which may need to be closely evaluated.

- If this new provision as well as section 194-O (i.e., for e-commerce operators) are applicable to a transaction, then this new provision will prevail.

03.

THE GIFT THAT KEEPS GIVING | IFSC INCENTIVES

Keeping with the Government's objective of promoting the International Financial Services Centre (IFSC) i.e. GIFT city, the Bill has proposed certain additional incentives for IFSC units and for transactions undertaken with IFSC units. These include:

- Exemption to non-residents with respect to income arising on transfer of offshore derivative instruments or over-the-counter derivatives entered into with an IFSC banking unit

- Exemption to non-residents with respect to income received from a portfolio of securities/financial products/funds, managed or administered by a portfolio manager (as defined under the relevant IFSC regulations) in an account maintained in an IFSC banking unit (to the extent such income accrues or arises or is deemed to accrue or arise outside India, and therefore, the exemption seems clarificatory).

- Incentives provided to aircraft leasing business in the Budget 2021 for certain income streams (i.e., royalty and interest earned by non-residents and income on transfer of aircraft earned by an IFSC unit) also extended to ship leasing business.

- Exemption from angel tax (i.e., tax applicable to a closely held Indian company on the issuance of shares to a resident at a premium in excess of fair value) to an Indian company in relation to the issuance of shares to an alternative investment fund regulated under the prescribed IFSC regulations.

Such tax incentives along with other proposed measures, such as setting up of an International Arbitration Centre in GIFT city and opening of world-class foreign universities and institutions in GIFT city (offering courses in financial management, fin-tech, technology etc.) with an aim of facilitating the availability of high-end human resources, should be expected to further boost the development of IFSC in India.

04.

BUSINESS REORGANISATIONS AND PROCEEDINGS UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2016 (IBC)

In case of mergers, demergers, the tax department may initiate tax proceedings for any year (subject to applicable limitation period) against the predecessor entity while the application for a scheme is pending before the relevant authority. However, pursuant to the order passed by the relevant authority, the predecessor entity may cease to exist during the course of tax proceedings resulting in the tax proceedings being considered invalid. To address this anomaly, it is proposed that the tax proceedings initiated or completed against the predecessor entity during such intervening period shall be deemed to have been carried out against the successor entity. Given that the applicability of this provision is not restricted to only those cases where the predecessor ceases to be in existence, its applicability in case of a demerger where the predecessor, as well as the successor, co-exist post the demerger, would need to be examined.

Further, in such restructuring cases, the tax return may have been filed by the predecessor/ successor entity without giving effect to the reorganisation/court order. To address this hardship, it is proposed that the successor entity files a modified tax return in accordance with the High Court/NCLT order within 6 months from the end of the month in which the High Court/NCLT order is issued. The Bill has also proposed to apply in the same form to companies undergoing resolution under IBC, where the order of the adjudicating authority under IBC is received after filing of the return by the successor under the Tax Act and such order relates to a period covered by such tax return. The provision does not deal with a corresponding revision of the predecessor entity's tax return for the same period, which seems to have been missed inadvertently.

Tax demands dealt with under IBC

One of the reliefs of a corporate resolution process under the IBC is a downward adjustment in the outstanding tax dues of the taxpayer. To give a corresponding effect to such adjustments under the Tax Act, it has been proposed that the tax authorities will modify the tax dues of the taxpayer in conformity with the order of the adjudicating authority under the IBC.

05.

TAX WITHHOLDING ON REAL ESTATE DEALS

A person buying immovable property (other than agricultural land) from a resident is required to withhold tax at 1% of the purchase consideration, regardless of the stamp duty value of the property.

To align this withholding tax provision with the extant capital gains tax provision, the Bill has proposed that for tax withholding purposes, the higher of (a) the purchase consideration and (b) the stamp duty value of the property, would be considered.

06.

COVID-19: TAX RELIEF IN RESPECT OF EX-GRATIA AMOUNTS PROVIDED FOR TREATMENTS

The Bill has proposed to exempt financial assistance received by an individual from an employer or any person, for expenses incurred towards the treatment of Covid related illnesses of himself or his family.

Further, any ex-gratia amount received upon the death of a family member due to Covid-related illnesses is proposed to be exempt:

- Without any monetary limit when such amount is received from the employer of the deceased person; and
- To the extent of INR 10 Lakhs (in aggregate) if received from any other person.

07.

'SOURCE OF SOURCE' OF BORROWING TO BE EXPLAINED

The provision requiring taxpayers to explain the source of source of funds credited in the books (as share capital and related receipts in certain scenarios) is being widened to include credits in the nature of loans and borrowings. In the absence of a satisfactory explanation, such credits could be deemed as taxable income in the hands of the recipient, which are taxable at double the tax rate applicable ordinarily (i.e., 60%). Accordingly, in the case of credits in the nature of loans and borrowings, the taxpayer would not only have to explain the source of such credit i.e., the details of the person lending or providing credit, but also the source of the source of such credit i.e., the source of funds in the hands of the lender or the creditor.

Given that the unexplained credits are taxable at a higher rate of tax, it is an important proposal as it casts an additional onus on the taxpayer to substantiate the genuineness of borrowings reflected in its books of accounts.

08.

SCOPE OF "BONUS STRIPPING" PROVISIONS WIDENED

The Bill has proposed to expand the applicability of the "bonus stripping" provision (which currently applies only to units of a mutual fund) to all securities (defined to include stocks and shares) and units issued by a Real Estate Investment Trust (REIT), Infrastructure Investment Trust (InvIT) or Alternative Investment Fund (AIF) as defined under the Tax Act read the relevant regulations issued by the Securities Exchange Board of India (SEBI).

As per this provision, if a taxpayer acquires securities/units within 3 months prior to the date of issuance of bonus securities/units (i.e., the record date) and the original securities/units acquired are transferred within 9 months after the record date (while the bonus securities/units continue to be held), the loss on the transfer of such original securities/units would be ignored for the purpose of computing the income of the taxpayer. However, given that such loss shall be allowed as the cost-basis of such bonus securities/units (at the time of transfer), this provision is not likely to result in an increase in the overall tax liability of the taxpayer and is essentially an anti-abuse measure to ensure that transactions are not undertaken in such form merely to establish a loss and avoid/reduce taxes to the extent of such loss.

09.

SCOPE OF TAX-DEDUCTIBLE EXPENSES REFINED

While computing the business or professional income of a taxpayer, deductions are allowed for all such expenses incurred in relation to such business/profession, subject to certain prescribed exceptions. The Bill has proposed to resolve the position regarding certain deductions which have been contentious and clarify the provision where there has been ambiguity in its application. The proposals in the Bill are as follows:

- Cess (which is levied on the base tax rate increased by surcharge) shall be treated as akin to "tax", and hence shall not be allowed as a deduction against taxable income of a taxpayer. This clarification shall be applicable retrospectively from 1 April 2005 and seeks to put to rest the ongoing litigations on this issue.

- Expenses incurred to provide any benefit or perquisite to any person, and where the acceptance thereof by such person is in violation of any law, rule, regulation or guideline, governing the conduct of such person, shall be considered as expenses for an illegal purpose, and hence shall not be treated as a deductible component. In terms of impact, any benefits/perquisites provided by a pharmaceutical company to medical practitioners (and their professional associations) which are prohibited under the relevant guidelines applicable to medical practitioners, should be covered under this provision.

- Expenses for a purpose which is an offence or prohibited by any foreign law and expenses incurred to compound an offence under any law (including a foreign law), shall also be considered as expenses which are for an illegal purpose, and hence shall not be an income tax-deductible item.

10.

WITHHOLDING TAX ON NON-CASH BENEFITS IN BUSINESS OR PROFESSION

The Bill has proposed a new withholding tax provision requiring a person providing a benefit or a perquisite arising from a business or a profession, to withhold tax at 10% of the value of such benefit. The objective is to ensure that such receipts, which are otherwise taxable in the hands of the recipient, are duly reported and do not avoid taxation on account of lack of reporting by the recipients.

Recognising that such benefits could be non-cash (wholly or partly) it is proposed that the person providing such benefits ensures that tax is paid before such benefits are provided. There is a relaxation where the value of the benefit is nominal (aggregating to INR 20,000 in the relevant year) or where the benefits are provided by an individual or an HUF having turnover or gross receipts up to the prescribed threshold.

11.

CONVERSION OF INTEREST INTO DEBENTURE NOT 'ACTUAL PAYMENT'

Under the Tax Act, deductions of *inter alia* interest payments on a loan or borrowing from a bank, NBFC, or other financial institution are allowed to taxpayers only upon 'actual payment' of such interest. Despite the provision specifically providing that deductions will not be allowed in situations where such interest has been converted into a loan or borrowing or advance, taxpayers often claim a deduction upon the conversion of interest payable on an existing loan into a debenture.

While this position has been upheld by several courts and is buttressed by taxpayers asserting that such a conversion is a constructive discharge of their liability and hence amounts to 'actual payment', the proposals under Bill emphasise that it is in conflict with the intent of the legislation.

Accordingly, the Bill has proposed that the conversion of interest payable into a debenture or any other instrument by which liability to pay is deferred to a future date, shall also not be deemed to have been actually paid and cannot be claimed as a deduction.

12.

FACELESS BUT NOT VOICELESS

To streamline the faceless assessment process and address certain legal and procedural aspects, the following key steps have been proposed:

- Procedural non-compliance under the faceless assessment regime: The provisions rendering an assessment order invalid merely due to non-compliance with the procedural aspects as laid down in the faceless assessment provisions, to be deleted. This provision had resulted in the quashing of several orders by the Indian courts under the extant faceless assessment regime and therefore, the proposed deletion is welcome.

- Personal hearing: The tax officer to allow personal hearing if requested by the taxpayer without the requirement to obtain prescribed approval as per the extant law. A positive step indeed, and if adhered to in true spirit will go a long way in reducing frivolous additions and related litigation.

13.

RE-ASSESSMENT PROVISIONS REINFORCED

Pursuant to the Budget 2021 amendment (effective from 1 April 2021), tax authorities can re-open the proceedings for any FY (subject to the applicable period of limitation) provided they have 'information' that suggests that the income chargeable to tax has escaped assessment. The term 'information' was defined narrowly, which is now proposed to be widened to also include the following:

(i) information received from foreign jurisdictions under the exchange of information mechanism;

(ii) any information obtained by the tax officer from any person in accordance with the Tax Act; and

(iii) any information which requires action in consequence of the order of a tribunal or a court.

Further, presently, reopening proceedings can be initiated at any time within 11 years from the end of the relevant FY if the tax officer has in his possession books of accounts, documents or evidence which reflect that income of INR 50 Lakhs or more represented in the form of an asset, has escaped assessment.

The 11-year period is being extended to cases where the income of INR 50 Lakhs or more has escaped assessment and is represented in the form of (a) expenditure relating to a transaction or an event, or (b) an entry(ies) in the books of accounts.

The expansion of the definition of 'information' is stated to be clarificatory but the same would effectively broaden the basis for reopening and include several additional situations within its ambit. Further, an extension of the 11-year period to cases where income is represented in the form of expenditure, or a book-entry widens the scope of reopening for a longer period of 11 years and could effectively cover a wide range of cases.

14.

FILING OF AN UPDATED TAX RETURN | A WORTHY CHANCE FOR TAXPAYERS!

Presently, taxpayers can file tax returns for a period up to a maximum of 9 months from the end of the relevant financial year (Existing Due Date).

To encourage voluntary compliance and enable the taxpayers to rectify tax returns, it has been proposed that a taxpayer should be permitted to file an updated tax return post the Existing Due Date and within 36 months from the end of the relevant FY.

The taxpayer availing such option would be required to pay (a) the applicable taxes along with interest on the additional income determined under the updated tax return; and (b) an additional tax at (i) 25% of the tax and interest referred to in (a), if the updated tax return is filed within 24 months of the relevant FY; or (ii) 50% of the tax and interest referred to in (a), if the updated tax is return is filed post 24 months but within 36 months of the relevant FY. The tax, interest and additional tax would have to be paid before filing the updated tax return.

However, this option would not be available in the following cases: (a) where the taxpayer claims a loss in the updated return; (b) the updated tax return reduces the tax liability or increases the refund claimed in the tax return filed (if any) within the Existing Due Date; (c) the taxpayer has recently been subject to search or survey proceedings; (d) the taxpayer has been subject to assessment, reassessment or revision for the relevant FY; (e) the tax officer has information in respect of the taxpayer under Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976 or the Prohibition of Benami Property Transactions Act, 1988 or the Prevention of Money-laundering Act, 2002 or the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, which has been communicated to the taxpayer; (f) the tax officer has received information from offshore jurisdictions which has been communicated to the taxpayer; (g) where prosecution has been initiated on the taxpayer for the relevant FY; or (h) an updated return has already been filed for the relevant year.

This is a welcome move that would enable the taxpayers to correct their filings or avail the benefit of an extended time frame to undertake tax compliance albeit, with an additional cost. While a more inclusive scheme with fewer pre-conditions may have been ideal, given the intent of this proposal, its implementation may reduce litigation to some extent and augment the Government's motto of 'Minimum Government - Maximum Governance'.

– *KCO | Direct Tax Team*

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AMBITION STATEMENT

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