**POST–BUDGET MEMORANDUM 2023-24: DIRECT TAXES**

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**POST–BUDGET MEMORANDUM 2023-24: DIRECT TAXES**

| **Sr. No.** | **Subject** | **Comments / Recommendations** |
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| **General Representations** |
|  | **Improve ease doing business in India through creation of favorable investment climate and easing of cumbersome tax compliance obligations** | * **Rationale and Issue**
	+ As the Finance Minister rightly acknowledged in her Budget Speech 2023, in a world that is still yet to fully emerge from the economic crisis resulting from the uncertainty caused by the COVID-19 pandemic and the Russia-Ukraine war, the world is looking upon India as a bright star. Coming in the backdrop of the supply-chain disruptions faced by MNE Groups in the recent past, India is also looked upon by the industry as an optimum solution to diversify their supply chain models to set-up manufacturing hubs at locations other than China or Taiwan as part of the China-Plus-One Strategy.
	+ It is imperative to leverage upon the Make-in-India initiative of the incumbent Government to maintain (if not improve) the attractiveness of India as an investment destination for new manufacturing units.
	+ As against this, there are various proposals in the Finance Bill (FB) 2023 which run counter to the Government efforts to enhance ease of doing business. Briefly, some of them are as follows:
1. Extension of applicability of S. 56(2)(viib) taxation to non-resident investors
2. Introduction of provisions enabling tax authority to direct taxpayer to obtain inventory valuation report from cost accountant
3. Absence of extension of sunset dates u/s 115BAB, S. 194LC and S. 194LD
4. Expanding scope of prosecution for default of non-deduction of tax on payments in kind
5. Expanding scope of withholding of tax refunds pending assessment/reassessment of other years
6. Expanding scope of s.28(iv) and s.194R to cash benefits thereby creating ambiguity on bad debt write off
7. Enhancing TCS rate on LRS steeply from 5% to 20%
	* The above, cumulatively, has the effect of diminishing the luminescence of India as a favorable investment destination in the international context.
	* Similarly, various cumbersome TDS/ TCS provisions have been introduced over the last few years such as 194Q and TCS u/s. 206C(1H) some of which may even have a degree of overlap in scope requiring specific provisions to address their interplay. These complex provisions are stated to have been introduced with the objective of tracking and tracing transactions in order to widen the tax net and ensure the Government has adequate information to subject the said transactions to tax.
	* However, such transactions being subject to GST, there is already an audit trail available with the GST Department which can be easily leveraged by the Income tax Department through electronic sharing of data on automated basis and making use of Artificial Intelligence to mine the data to detect tax evasion. TDS and TCS on sales results in multiple levy of tax on same transaction.
	* Contrary to intent of deepening and widening the tax net, the compliance burden and falls innocent and honest taxpayers who are already within the tax net.
* **Recommendations**
	+ When India is at cusp of achieving high growth rate amidst global headwinds, the Government should refrain from taking any steps which may diminish the attractiveness of India as an investment destination. To this end, it may be beneficial to withdraw the amendments above. If necessary, instead of general anti-abuse provisions, specific targeted provisions may be introduced to target tax evaders instead of creating hardship for honest and compliant taxpayers.
	+ Additionally, various proposals listed above may be revisited/ withdrawn in light of discussion hereunder. Separately, provisions for TDS/ TCS on purchase and sale of goods u/s 194Q and s. 206C(1H) may be reconsidered and scope reduced to purchase from or sale to non-GST registered vendors.
 |
| **Corporate Taxation** |
|  | **Extension of cut-off dates for eligibility to claim concessional tax/ withholding rate under s.115BAB by 2 years** | * **Existing provision**
	+ S. 115BAB of the Income Tax Act, 1961 (ITA), introduced vide The Taxation Laws (Amendment) Ordinance, 2019 (‘the Ordinance’) and subsequently enacted by the Parliament, taxes newly established manufacturing domestic companies at the concessional rate of 15% subject to certain conditions. One of the conditions to be eligible for the benefit is that the new company is required to be set‑up and registered on or after 1 October 2019 and commence manufacturing or production on or before 31 March 2023.
	+ The sunset date of 31 March 2023 for commencement of manufacturing and production was extended to 31 March 2024 by Finance Act (FA) 2022 considering the impact of the COVID-19 pandemic.
* **Issue**
	+ There is no proposal to extend afore-mentioned cut-off date of 31 March 2024 u/s 115BAB in the Finance Bill (FB) 2023.
	+ Given the volatile and uncertain global macroeconomic factors arising from Russia-Ukraine war and recessionary trends creeping in world-wide, a further extension of sunset date will be helpful to attract foreign investment to India. Apart from enabling India to remain attractive for making fresh capital and debt investments, such extension will also boost the forex reserves of the country in volatile times as also encourage the domestic economy while encouraging exports.
	+ Such extension will also promote the ‘Make in India’ initiative by helping India in maintaining attractiveness for setting up new manufacturing units mainly to promote exports in accordance with the China Plus One strategy by providing an alternative to multinational groups to set-up manufacturing hubs at locations other than China and Taiwan.
	+ Prior announcement of longer sunset date provides sufficient lead time to the foreign investors to make a planned and systematic implementation after evaluation of business plans, raising funds and setting up the new manufacturing facility.
	+ Furthermore, s.115BAB(7) requires companies desirous of availing the benefit to exercise the option by filing Form 10ID on or before the due date for filing the return of the first year for which the company is required to file return. S.139(1) mandates every company to furnish return of income for every year regardless of the level of income. This indicates that the new company should file Form 10ID on or before due date for filing the return for its first year even if the new manufacturing facility is not set up. Given the current sunset date of 31 March 2024, new companies which are already set up and required to file return for FY 2022-23 but do not expect to meet this deadline may not file Form 10ID. If the sunset date is subsequently extended by next year’s Finance Bill, it will become difficult for them to avail the benefit since they would have already missed filing Form 10ID to claim benefit of s.115BAB in the first year. Hence, an advance intimation of extension of sunset date will help such companies to file Form 10ID in timely manner to avail the benefit instead of getting caught in litigation on compliance of s.115BAB(7)
* **Recommendations**
	+ Accordingly, the sunset date for newly established manufacturing domestic companies u/s 115BAB may be extended till 31 March 2026.
 |
|  | **Extension of sunset date for commencing manufacturing operations for co-operative societies claiming CTR benefit of 15% tax rate [S. 115BAE]** | * **Proposed amendment**
	+ As per the extant ITA provisions, the benefit of concessional tax regime of 15% tax rate is only available to new manufacturing domestic companies (S.115BAB). In order to provide level playing field to manufacturing cooperative societies, FB 2023 has proposed to introduce a new provision of S.115BAE to provide concessional tax regime(CTR) of 15% tax rate to new manufacturing cooperative societies.
	+ In order to be eligible for 15% CTR, the new manufacturing co-operative societies are required to satisfy various conditions.
	+ One of the conditions is that the cooperative society should be set up and registered on or after 1 April 2023 and commences manufacturing on or before 31 March 2024.
	+ Other conditions which cooperative society needs to satisfy are that it should be resident in India, engaged in the business of manufacturing or production of article or thing, investment in unused plant and machinery, compliance with 80:20 ratio if plant and machinery is previously used for any purpose, satisfaction of formative splitting up/reconstruction conditions of a business already in existence, dealings between related parties should be at arm’s length etc.
* **Issue:**
	+ The CTR benefit of 15% has been proposed to provide boost to manufacturing operations in India and benefit is extended to manufacturing co-operative societies in order to provide level playing field with that of manufacturing companies. However, the time limit for formation of new co-operative society and commencing manufacturing operations is too short, i.e., the period should be between 1 April 2023 to 31 March 2024 (merely one year) as compared to time limit provided to domestic companies for formation of new company of around 4.5 years (i.e., on or after 1 October 2019 to on or before 31 March 2024).
	+ The short period of one year proposed for co-operative societies is likely to render the proposed amendment redundant in many cases because the gestation period to commence manufacturing activities is generally on a higher scale and it may be practically impossible when a mere period of one year is prescribed.
* **Recommendations**
	+ In order to boost growth of manufacturing co-operative societies , it is recommended that time limit of commencing manufacturing operations for co-operative society should be extended at least up to 31 March 2026 to allow sufficient time to raise funds and set-up of new manufacturing unit.
 |
|  | **Extension of time limit for availing concessional rate of 5% on interest income arising under section 194LC and section 194LD of the Act by 2 years** | * **Existing provision**
	+ Section 194LC of the Income-tax Act 1961 (ITA) provides for a concessional tax rate of 5% on interest income arising to non-residents in respect of monies borrowed in Foreign Currency (FCY) upto 30 June 2023 or in respect of monies borrowed by way of issue of rupee denominated bonds upto 30 June 2023. Thus, once the tenure of the monies borrowed is over, interest income shall be taxable in the hands of the non-resident at the rate of 20%/ 40%.
	+ Similarly, section 194LD of the Act provides for a concessional tax rate of 5% on interest income arising to Foreign Portfolio Investor (FPIs) on specified securities (i.e., rupee denominated bonds of an ICo and Government Securities – hereinafter referred to as ‘specified securities’) up to 30 June 2023. Hence, interest income arising to FPIs post 30 June 2023 on specified securities would be subject to tax at the rate of 20% under section 115AD of the Act.
	+ The concessional tax regime pertaining to section 194LD of the Act was first introduced vide the Finance Act, 2013 and the concessional tax rate of 5% was available on interest income arising up to 31 May 2015. Basis representations received from varied stakeholders, the Government extended the sunset date up to 30 June 2017 (vide Finance Act, 2015), thereafter to 30 June 2020 (vide Finance Act, 2017) and thereafter to 30 June 2023 (vide Finance Act, 2020).
	+ Similarly, section 194LC of the Act was introduced by the Finance Act, 2012 with effect from 1 July 2012 and the sunset date for the same was extended over a period of time upto 30 June 2023.
* **Issue**
	+ There is no proposal to extend the afore-mentioned cut-off date of 30 June 2023 u/s 194LC and 194LD is made in the FB 2023.
	+ At a time when the Government is promoting the involvement of private sector in the India-growth story through *“Sabka Prayas”* resulting in *“Jan Bhagidari”*, funds inflow to finance such private sector involvement may be necessary.
	+ The increased WHT rates of 20%/ 40% can have an adverse impact on the debt flows by foreign investors and disincentivize private capex investments by adding to the cost of the borrower. This will either result in higher cost implication for Indian borrower (if they are grossing up the tax) or lower returns for international investors (if they are absorbing WHT), either way sub-optimal making these borrowing / investment avenues less attractive. This will be counterproductive, given the nascent investment recovery process and reliance on foreign capital to fund medium-term investment requirements.
	+ Please note that while technically Tax deducted at source (TDS) in India may be eligible for claiming credit against corporate tax liability in the country of residence, practically, actual amount of tax credit may be negligible considering that the tax credit is restricted to the tax actually suffered in the country of residence. This may be explained by way of example with respect to India- Singapore treaty as follows:

|  |  |
| --- | --- |
| **Particulars**  | **Amount (INR)** |
| Interest on securities from India  | INR 100 |
| Withholding tax @ 15% under India-Singapore treaty  | INR 15 |
| Gross income from India  | INR 100 |
| Funding cost and other operating expenses in Singapore  | INR 65 |
| Overheads and other costs  | INR 15 |
| Net profit subject to Singapore Corporate tax  | INR 20 |
| Corporate tax rate in Singapore @ 17%  | INR 3.4 |
| Taxes from India expensed off to P&L.  | INR 11.6 |

* + The above is ~~not an actual calculation but is~~ an oversimplified representative example of how the tax credit rules actually work. Where the tax rate in the country of residence is NIL/ lower than 17% (as indicated in the above example), the credit of India taxes shall be not be available/ further reduced. If taxes are not creditable, the same reduces the effective yield of debt securities in India, making them unattractive as compared to their peers. In view of this, the current TDS rate of 5% needs to be continued for competitiveness of Indian debt market.
	+ Further, the provisions of section 194LD of the Act also provides that the rate of interest in respect of rupee denominated bonds of an Indian company shall not exceed the rate as the Central Government may, by notification in the Official Gazette, specify.
	+ In this connection, the Central Government *vide* Notification No. 56/ 2013/F.No.149/81/2013-TPL dated 29 July 2013 notified the following rates of interest in respect of rupee denominated bonds of an Indian company, namely:-
1. in case of bonds issued before the 1 July 2010, the rate of interest shall not exceed 500 basis points over the base rate of SBI as on 1 July 2010.
2. in case of bonds issued on or after the 1 July 2010, the rate of interest shall not exceed 500 basis points over the base rate of SBI applicable on the date of issue of the said bonds.
	* Accordingly, where the interest rates on rupee denominated bonds of an Indian company exceeds the 500 basis points over the base rate of SBI as provided above, the FPI shall not be eligible for concessional tax rate of 5% under the provisions of section 194LD of the Act and would be subject to tax at the rate of 20% under section 115AD of the Act.
	* Providing a cap on the interest rate limits the type of securities that can be covered under section 194LD of the Act and thereby restricts the participation of FPIs in the corporate debt market.
	* To achieve India’s economic goals along with the creation of “sustainable infrastructure”, it is imperative to tap global capital pool. Traditionally, banks have been the key financiers of India’s growth story. Capital markets which serve as an alternative to bank finance especially for long term funding would play a key role in the coming decades to help achieve the financing targets at a reasonable cost. The regulators have been vocal around promoting healthy and vibrant debt capital markets thereby reducing systemic risk to Indian banking sector. Continuing with concessional WHT regime will help keeping debt markets attractive to both Indian borrowers and international investors.
* **Recommendation**
	+ Thus, it is recommended that the Government extend the period of beneficial tax rate of 5% specified in section 194LC and section 194LD of the Act beyond 30 June 2023 without any specific sunset date.
	+ Additionally, it is also recommended that concessional tax rate of 5% should be extended to all rupee denominated bonds of an Indian company irrespective of the coupon rate applicable on the same.
 |
|  | **Removing stringent condition in S. 9A requiring validation of indirect participation of Indian investors in the offshore fund** | * **Existing provision**
	+ The Finance Act 2015 introduced section 9A into the ITA to mitigate potential adverse tax consequences for an offshore fund that is managed by an Indian fund manager. The tax safe harbor under section 9A of the ITA is subject to the conditions prescribed therein.
	+ One of the conditions prescribed in clause (c) of Section 9A(3) states as under:

*“the aggregate participation or investment in the fund, directly* ***or indirectly****, by persons resident in India does not exceed five per cent of the corpus of the fund.**Provided that for the purposes of calculation of the said aggregate participation or investment in the fund, any contribution made by the eligible fund manager during the first three years of operation of the fund, not exceeding twenty-five crore rupees, shall not be taken into account.”** + The objective of these conditions ostensibly relates to safeguarding the quality of the offshore funds that are sought to be managed from India in terms of the jurisdictions that they belong to, their ownership pattern, how the fund manager is being remunerated, etc.
	+ In this backdrop, the amendments made from time to time to the provisions of section 9A of the ITA and the Rules made thereunder to mitigate certain impediments, to enable offshore funds to avail the benefits of this regime and promote Indian fund management capabilities are acknowledged. Further, the pragmatic and progressive approach adopted by the CBDT while considering the approval for safe harbor in recent applications filed by certain offshore funds is also appreciated. These developments have sent an encouraging message to the industry participants with regard to the Government’s intention in developing India’s domestic fund management industry.
* **Issue**
	+ Having said the above, the provisions of Section 9A of the ITA with the amendments thereto have been completely inadequate for fund managers in India to be able to manage foreign funds. Section 9A has not been able to achieve its objective to encourage the domestic fund management industry, as the conditions of the section have been stifling for foreign funds and the Indian managers.
	+ One particular key contributor towards this is the condition in section 9A(3)(c) above, pertaining to tracing participation by Indian investors in such offshore funds, which has perhaps been the most challenging for the funds/fund managers to comply with.
	+ The purpose of this condition is to ostensibly check round tripping of Indian monies via global funds. While the Funds seeking approval under section 9A of the ITA are able to validate the participation of direct investors (being natural persons in the Fund), in the context of the global fund industry, a significant set of investors in such Funds would include institutional investors or reputed discretionary wealth managers who allocate a portion of the wealth managed by them on behalf of their clients to specified asset managers. In such cases, the eligible investment managers have no access to the investors in those funds or the clients of the wealth managers.
	+ In order to alleviate the above challenge, Rule 10V(2) of the Income-tax Rule, 1962 (Rules) was introduced to provide that where the direct investor is the Government / Central bank / sovereign fund / appropriately regulated investor, the fund should obtain a written declaration from the direct investor regarding the participation, if any, of Indian residents in that fund.
	+ Additionally, where the direct investor in the Fund is an unregulated fund, the fund is required to undertake ‘appropriate due diligence’ to ascertain the indirect Indian participation and the extent thereof. There is currently no clarity on what would be deemed to be appropriate due diligence but in approvals that have been granted by the CBDT to date, Funds have been intimated that they *‘should be in a position to provide information of ultimate beneficial owners being Indian residents, when called for, in case their investment in the Applicant exceeds 5%’*.
	+ Practically, obtaining such declarations from institutional investors is extremely difficult since:
1. It is practically impossible to verify participation by Indian residents on an ongoing basis in cases where the eligible investment fund is an open-ended fund or listed on overseas stock exchanges.
2. Given the broad-based nature of these funds, obtaining declarations for each investor (solely to validate Indian tax residence) is not practically possible.
3. Despite several efforts by fund administrators, most sovereign investment funds and government / state pension funds have practically refused to provide such declarations on account of the amount of diligence that would need to be done to provide such a declaration. Furthermore, the India allocation of the corpus may also be a small portion of the global fund.
4. In many cases, the institutional investors may themselves have institutional investors and getting such declaration up the chain is impossible.
5. There is no real incentive to go through all the documentation effort and monitor such participation as there is no tax benefit provided to the fund manager upon obtaining an approval under section 9A and the fund could very well continue to operate without any such requirement by simply moving/keeping the fund manager outside India.
* **Recommendations**
	+ It is a humble recommendation that the requirement to track the **indirect** participation by persons resident in India be deleted.
	+ The 9A regulations were introduced to promote fund management in India; however, based on the current provisions of the ITA, the requirement to trace Indian ownership is more onerous than KYC/AML regulations which have been designed to identify natural investors/ track money laundering/round tripping.
	+ In addition, in the FPI context, participation or investment by Indian residents is adequately regulated and monitored by SEBI. SEBI, from time-to-time, issues guidelines on restrictions of investment by Indian residents in an FPI. Given that SEBI already prescribes Guidelines in this regard, which are well understood and followed by market participants, there should not be any additional requirement under section 9A of the ITA with respect to the participation of Indian residents.  As per the extant SEBI (Foreign Portfolio Investors) Regulations, 2019, the aggregate contribution of NRIs, OCIs and Indian tax residents is permitted upto 49% of the total contribution in the corpus of the FPI with a single resident permitted to invest upto 25% of the corpus. Furthermore, only FPI applicants that are themselves resident in, or have an investment manager that is resident in an FATF member country are accorded Category - I FPI status with non-FATF member country FPI’s subject to more stringent KYC requirements with regard to ultimate beneficial owners (UBO). This demonstrates SEBI’s strict oversight over tracking ultimate ownership which would be readily available to Government authorities as required.
	+ Separately, per the recent Foreign Exchange Management (Overseas Investment) Directions, 2022, a person resident in India has also now been permitted to invest in a foreign entity that has invested or invests into India, directly or indirectly, up to two layers of subsidiaries, without RBI approval.
	+ Considering the above, it is humbly submitted that the ITA is neither an appropriate statute for governing and regulating this aspect, nor will it be able to keep pace with the updates/ amendments made by the relevant Regulator from time-to-time resulting into compliance with such onerous requirement on an ongoing basis.
	+ A progressive regime enabling the management of offshore funds from India will help create an ecosystem for fund management, employment, talent, investment flows and nurturing of global best practices in the market. In particular, it would also help create employment opportunities in the fund management industry and encourage talent to remain in the country and contribute to the economic growth.
	+ The Government of India in the Economic Survey 2019-20 (Chapter 9 – Services Sector) also recognized the need for the development of the offshore fund management industry to boost financial services exports with the following comments in relation to the need to rationalize section 9A of the ITA.

*“….., most offshore funds have been unable to utilize the ‘safe harbour’ provisions (under section 9A) since they have to satisfy a total of 17 stringent eligibility conditions related to the fund’s structure, investor composition, investment activity and fund manager’s activity and remuneration. Some of these conditions are not in sync with the structure and investment pattern of offshore funds and nature of FPI inflows into India, and lead to dual compliance burden for offshore investors since they are also required to comply with RBI and SEBI regulations related to end-investors in FPIs and round- tripping.**In comparison, in key fund management jurisdictions such as USA, UK, Singapore and Hong Kong, the eligibility conditions under ‘safe harbour’ provisions for offshore funds are fewer and less stringent in many cases, with discretion available to tax authorities to evaluate the offshore fund’s structure and investment pattern and allow for exceptions on a case-by-case basis.**In view of the above challenges, the Commerce Ministry’s High-Level Advisory Group (HLAG) Report (September 2019) recommended simplifying the tax framework and removing tax residency risk for offshore funds wanting to on-shore their fund management activity given that the offshore fund and fund manager are registered with SEBI and compliant with SEBI regulations. Operationalizing the ‘safe harbour’ regime of Section 9A, Income Tax Act (1961) would enable on-shoring the fund management activity of India-focused offshore funds, and potentially, regional/global offshore funds with partial allocation to India. It would also enable greater delegation of fund management activity of FPIs to India as FPI inflows continue to rise in the coming years.”** + Basis the information available in public domain and EY research, it is attempted to forecast the benefits to the Government of India in terms of incremental tax revenues as a result of simplifying the section 9A regime.
	+ Even with a conservative estimate of 20% of the assets under management of FPI  (USD 627 bn[[1]](#footnote-2)) , Private Equity / Venture Capital funds (~USD 409 bn[[2]](#footnote-3)) being managed from India and a 0.5% management fee, rationalizing this regime could yield inflows amounting to USD 1.03 bn.  A booming fund management industry helps to develop several ancillary services such as trusteeship services, custodial services, and fund administrators.
1. Section 9A of the ITA is not an incentive scheme but merely confers a protection to offshore funds from any potential adverse Indian tax consequences.
2. The offshore funds will continue to discharge appropriate taxes on their gains from investment in Indian capital markets (irrespective of the location of the fund manager).
3. FPIs and Indian fund managers are registered with and regulated by SEBI; and
4. SEBI monitors compliance with KYC and anti-money laundering norms by FPIs on an ongoing basis.
	* Hence, in order to provide a fillip to the development of India’s fund management industry and Government of India’s Make in India initiative as also provide a significant boost to the participation of Indian fund managers seeking to manage global pools of capital under the section 9A regime, the above recommendations may be accepted.
 |
|  | **Liberalize the provisions to allow deduction of all legitimate expenses incurred for commencement or extension of business [S. 35D]** | * **Existing provision**
	+ S.35D allows an Indian company or any other resident person to amortize preliminary expenses, over period of 5 years, which are incurred before the commencement of business or towards extension of any undertaking post commencement of business.
	+ The eligible business expenditure which are allowed as deduction are enlisted under S.35D(2), these include:
		1. Expenditure incurred towards preparation of the feasibility or project, conducting of the market survey or the engineering services. This is further subject to condition that work in this connection is carried out by the taxpayer itself or the concern approved by CBDT.
		2. Legal charges paid for drafting agreements as necessary for setting up or conduct of the business of the taxpayer.
		3. Expenditure incurred towards legal charges for drafting or printing Memorandum and Article of company, registration of company, the issue of shares or debenture for public subscription being underwriting commission, brokerage, and charges for drafting, typing, printing and advertisement of the prospectus.
		4. Other expenditure as may be prescribed.
	+ The aggregate deduction under this section is further capped to 2.5% of ‘cost of project’ or in case of Indian company, at its option, ‘capital employed in business’ (excluding share premium).
* **Proposed amendment**
	+ The work pertaining to feasibility or project reports, survey, engineering services could be carried out by any concern even if not approved by CBDT. Pursuant to amendment there is no requirement for the work to be carried out by only such concerns as approved by CBDT.
	+ The taxpayer incurring such preliminary expenditure needs to prepare and furnish a statement before tax authority in prescribed form within a certain time limit.
* **Issues**
	+ As a welcome step, proposed amendment would ease out the compliance burden for companies since they are not required to obtain feasibility or project reports from CBDT approved consultants. However, the scope of S.35D continues to be restrictive and covers limited expenditure within its scope.
	+ Increase in share capital other than public issue is not covered
		1. Present scope of S.35D(2) restricts the allowability of expenses in connection with issue of shares which is public offer. The expenses incurred towards issue of shares under private placement or to Qualified Institutional Buyers etc. are not within the ambit of section.
		2. Taxpayer incurs various expenses for raising funds from private players including statutory fees for increase in authorized capital, legal fees, certifications from auditors, payments made to merchant bankers etc.
		3. Since the expenditure incurred is in nature of capital and not revenue, the same is also not allowable as business deduction while computing business income. Further, expenditure cannot form part of “actual cost” of depreciable asset to claim depreciation allowance.
		4. The taxpayer raising funds from private issue are burden with cost of issue which is not allowable as revenue deduction or as depreciation or as preliminary expenditure under S.35D.
	+ The quantum of deduction is restricted to 2.5% of “cost of project” or “capital employed in business” (excluding share premium), whichever is lower
		1. The section presently limits the maximum amount of expenditure allowable as deduction. This is irrespective of fact that taxpayer incurs legitimate business expenditure before or post commencement of business.
		2. Taxpayer incurring legitimate business expenditure in excess of upper limit placed under section are burdened with such cost which is not allowable as revenue deduction or as depreciation or as preliminary expenditure under S.35.
	+ S.35D was inserted by Taxation Laws (Amendment) Act, 1970 on the recommendation of Bhootalingam Committee on the principle that the tax law should allow deduction or amortization for all legitimate business expenditure. Since then, there is no change or modification to list of expenses under S.35(2) which are allowable as expenditure. The change in business models and regulatory requirement etc., requires taxpayers to incur several expenses in connection with commencement of business. Existing list fails to capture and allow deduction for such expenditure which are genuine in nature.
	+ In either of the above situations, the additional cost may remain as sunk cost for taxpayers. Hence, there is need to liberalize the provisions to allow legitimate business expenditure.
* **Recommendations**
	+ It is recommended that S.35D(2) be modified to allow expenditure incurred towards issue of shares whether through public offer or private placement.
	+ It is recommended to remove limit of 2.5% of “cost of project” or “capital employed in business” (excluding share premium) to liberally allow amortization for all legitimate business expenditure.
	+ It is recommended to revamp the provision of S.35D(2) with more liberalized approach to allow genuine and legitimate expenses incurred in connection with commencement of business which neither depreciable nor allowable as revenue deduction.
 |
|  | **Resolving practical difficulties in identifying MSE to avoid deduction of delayed payments on actual payment basis [S. 43B]** | * **Existing provision**
	+ Provisions of section 43B provide for deduction of specified expenditures on actual payment basis.
	+ Further, where during a financial year, taxpayer is not able to make actual payment of the expenditure incurred by the taxpayer during the relevant financial year, still such expenditure can be claimed as a deduction by the taxpayer – subject to making actual payment of such expenditure within the due date of furnishing the tax return of such financial year.
* **Proposed amendment**
	+ A new clause (h) is proposed to be inserted in the provisions of section 43B which provides that, any sum payable by the taxpayer to a micro or small enterprise (MSE) beyond the time limit specified in section 15 of the Micro, Small and Medium Enterprises Development Act, 2006 (MSME Act) shall be allowed as a deductible expenditure only on actual payment. The impact of the proposed amendment is that any sum which becomes payable to MSE and remains overdue in the same financial year, then such expenditure will be allowed as a deductible expenditure only in that financial year in which the actual payment is made. If the actual payment is made during same financial year – even if delayed beyond time limit u/s. 15 of MSME Act, it will be allowed as deduction in same financial year.
	+ Amendment is also proposed in the proviso to section 43B to exclude proposed clause (h) within the ambit of the said proviso. The impact of the proviso is that, with regard to the expenditure of the nature referred to in clause (h) to section 43B, the buyer shall not be granted benefit of making actual payment of such overdue sums till the due date of furnishing its return of income. Accordingly, deduction for such overdue sums shall be allowed only where such sums were actually paid within that financial year.
* **Issue**
	+ Reference made in proposed clause (h) to section 43B is to a sum payable to a “micro or small enterprise”. The term, “micro enterprise” and the term, “small enterprise” have been defined in the proposed amended clause (e) & (g) to Explanation 4 to section 43B.
	+ In terms of the proposed amendment to Explanation 4, for the purpose of defining the terms, “micro enterprise” and “small enterprise”, reference has been drawn to section 2(h) and section 2(m) of the MSME Act, respectively. In terms of section 2(h) and section 2(m) of MSME Act, an enterprise shall be classified[[3]](#footnote-4) as a “micro enterprise” or a “small enterprise” depending upon the quantum of investment in the plant & machinery and annual turnover.
	+ The classification of MSEs is based on their investment and turnover as follows :-

| **Classification** | **Micro enterprise** | **Small enterprise** |
| --- | --- | --- |
| Investment in Plant & Machinery | < Rs. 1 Cr. | < Rs. 10 Cr. |
| Annual Turnover | < Rs. 5 Cr. | < Rs. 50 Cr. |

 * + The MSME Act only refers to a criterion of turnover and investment in plant & machinery so as to qualify as a “micro or small enterprise” in terms of section 7 of the MSME Act. It is unclear as to whether, the enterprise should file a memorandum under section 8 of the MSME Act that it fulfills the criteria for qualification as a “micro or small enterprise” (in terms of section 7 of MSME Act) i.e., registration on Udyam portal. Hence, there is an ambiguity as to whether an enterprise (not registered under the MSME Act) fulfilling the criteria for being recognized as a “micro or small enterprise” under section 2(h)/(m) of MSME Act, shall qualify as a “micro or small enterprise” as referred to in proposed amendment to Explanation 4 of section 43B?
	+ It is practically challenging for any taxpayer to identify whether its vendor satisfies the MSE criteria in absence of a simple procedure. Self-declaration by the vendor may not fully address this issue since vendors may give false declarations just to receive payments earlier than normal trade practice.
	+ It may be noted that the Hon’ble Supreme Court in the case of Silpi Industries Ltd. v. Kerala State Road Transport Corporation & Anr. (Civil Appeal No. 1570-1571 of 2021) held that only MSEs registered on Udyam portal can claim benefit of MSMED Act
* **Recommendations**
	+ It may be clarified that the provisions of non-allowability of overdue expenditure are applicable only where the expenditure is incurred in relation to enterprises which are registered under MSME Act on Udyam portal.
 |
|  | **Permit set-off of brought forward losses against presumptive income [S. 44BB]** | * **Existing provision**
	+ Section 44BB was introduced vide Finance Act 1987, as a measure of simplification providing for determination of income of a taxpayer engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils [commonly referred to as “eligible assessee”] at 10% of aggregate receipts as provided in sub-section (2).
	+ Consequently, Finance Act 2003 amended section 44BB by way of inserting sub-section (3) to provide that an assessee may claim lower profits and gains than the profits and gains specified under sub-section (1) of section 44BB if he keeps and maintains such books of accounts and gets his accounts audited.
	+ By virtue of the said amendment, an eligible assessee is allowed to prepare books of accounts in order to claim profits lower than 10% of aggregate receipts.
* **Proposed amendment**
	+ Finance Bill 2023 proposes to amend section 44BB by inserting sub-section (4) which states that no set off of unabsorbed depreciation and brought forward loss shall be allowed to the assessee where income is offered to tax under sub-section (1) i.e., at 10% of aggregate receipts.
	+ The proposed new sub-section (4) in S. 44BB states as follows:

*(4) Notwithstanding anything contained in sub-section (2) of section 32 and sub-section (1) of section 72, where an assessee declares profits and gains of business for any previous year in accordance with the provisions of sub-section (1), no set off of unabsorbed depreciation and brought forward loss shall be allowed to the assessee for such previous year.** + The aforesaid amendment implies that unabsorbed depreciation and brought forward loss can only be set off only when assessee offers income under net basis i.e., prepares books of accounts and gets them audited and that too when the income under net basis is less than 10% of the gross receipts as preparation of books is permitted only if expected income is less than 10% of gross receipts under section 44BB(3) of the Act.
* **Issue**
	+ It is pertinent to note that the Oil & Gas industry witnessed a downfall from 2014 onwards which led to massive losses which also led to several industry players becoming bankrupt and shutting down business operations. The industry again faced a hit during the COVID-19 pandemic which added to the bucket of losses. It is now that the Oil & Gas market is recovering, and the industry is making profits and such losses could be set off. It may be appreciated that the losses incurred and claimed by the assessees’ in their tax returns are actual losses on account of several reasons such as:
1. Cost overruns,
2. Under budgeting of costs,
3. Bidding for contracts at lower rates to secure business, etc.
	* The proposed amendment restricts set off of losses already incurred and claimed in the return of income. The current language of the proposed amendment suggests that it is applicable to the losses already incurred and hence, such restriction to that extent becomes retrospective in nature.
	* The intent of the proposed amendment as stated in the memorandum to Finance Bill 2023 is to restrict claiming of losses as per sub-section (3) against profits under sub-section (1). An extract of the memorandum is as follows:

*“taxpayers opt in and opt out of presumptive scheme in order to avail benefit of both presumptive scheme income and non-presumptive income. In a year when they have loss, they claim actual loss as per the books of account and carry it forward. In a year when they have higher profits, they use presumptive scheme to restrict the profit to 10% and set off the brought forward losses from earlier years. Conceptually, if assessee is maintaining books of account and claiming losses as per such accounts, he should also disclose profits as per accounts. There is no justification for setting off of losses computed as per books of account with income computed on presumptive basis.”** + As regards unabsorbed depreciation, the same shall is anyway deemed to be allowed under section 32(2) where the eligible assessee files income-tax return on gross basis, i.e., under section 44BB(1) of the Act, as the provision has a “non-obstante” clause w.r.t. section 28 to section 41 and section 43 and 43A. Thus, an assessee can never obtain the benefit of unabsorbed depreciation unless it opts to offer income on net basis in the subsequent year (which is allowed only where profits are lower than 10% of aggregate receipts). Hence, even under the current regime, benefit of unabsorbed depreciation is not available to the assessee who opts for section 44BB(1). To this extent, the said amendment is academic.
	+ However, the amendment could result in a scenario when losses incurred by the assessee cannot be set off at all. For example, if an assessee incurred losses in earlier years and the income under net basis in subsequent years is marginally higher than 10%, say 11% or 12%, still the assessee would not be able to prepare books of accounts [as per restriction under section 44BB(3)] and none of the losses would be utilized. This will lead to a discrimination between assessee referred to in section 44BB vis-a-vis all other assesses. Further, such brought forward losses may get lapsed due to limitation on expiry of 8 years under section 72 of the Act. Thus, this could result into significant financial impact.
	+ It is respectfully submitted that the law granted a right to the assessee to claim losses and allowed set off of such losses against future profits irrespective of the method chosen to offer income to tax. Such right granted by the law is a vested right. Keeping in mind the general principle that vested rights cannot be divested, it is a statutory right of the assessee given by the law to set off the losses against the profits irrespective of the method under which income is offered to tax.
	+ Given the above and the significant nature of such amendment, the amendment ought to be prospective in nature and applicable to the losses incurred from 01 April 2023 onwards. Restriction on set off past losses is against the principle of vested rights and would put participants in the Oil & Gas sector at a significant disadvantage via-a-vis other assessees.
	+ Current language of the proposed amendment suggests that an eligible assessee cannot claim any past incurred losses as well from income offered under section 44BB(1). Hence, there is an anomaly that the said amendment restricts the right vested for assessee’s which already have brought forward losses of the past and to such extent, such amendment is retrospective in nature.
	+ In this regard, reliance is placed on the decision of Supreme Court in the case of Chairman, Railway Board v/s C.R. Rangadhamaiah [RR1] [AIR 1997 SC 3828 (3837)] wherein it is stated that a retrospective amendment cannot be imposed in order to strike down a “vested right” held by the appellant and thereby taking away the benefits available under the said rules. The relevant extract of the decision is as follows:

*“Para 17 - In many of these decisions the expressions "vested rights" or "accrued rights" have been used while striking down the impugned provisions which had been given retrospective operation so as to have an adverse effect in the matter of promotion, seniority, substantive appointment, etc., of the employees. The said expressions have been used in the context of a right flowing under the relevant rule which was sought to be altered with effect from an anterior date and thereby taking away the benefits available under the rule in force at that time. It has been held that such an amendment having retrospective operation which has the effect of taking away a benefit already available to the employee under the existing rule is arbitrary, discriminatory and violative of the rights guaranteed under Articles 14 and 16 of the Constitution. We are unable to hold that these decisions are not in consonance with the decisions in Roshan Lal Tandon (supra), B.S. Yadav (supra) and Raman Lal Keshav Lal Soni and others”** + Further, the Indian Government has also time and again stated that it is not in the favour of introducing any retrospective amendments. Hence, the aforesaid amendment may also be considered to be made prospective, i.e., for losses incurred on or after 01 April 2023.
* **Recommendation**
	+ Proposed amendment to section 44BB should be modified to make it applicable for unabsorbed depreciation and brought forward loss incurred 01 April 2023 onwards. Unabsorbed depreciation and brought forward loss incurred prior to 01 April 2023 should be allowed to set off against profits under sub-section (1).
 |
|  | **Relax investment at high premium by bona fide non-resident investors from “angel tax” u/s. 56(2)(viib)**  | * **Existing provision**
	+ S.56(2)(viib) is triggered when a closely held company (CHC) issues shares (including preference shares) to a **resident** at a premium and receives consideration which is in excess of fair market value (FMV) of shares.
	+ The FMV is computed at higher of (i) Book value of shares as per Rule 11UA(2)(a) (ii) Discounted Cash Flow (DCF) computed by Category I merchant banker as per Rule 11UA(2)(b) (iii) subjective satisfaction of Assessing Officer based on value of intangibles
	+ Presently, the provision is applicable only in case of issue of shares to residents and does not apply to non-residents.
	+ This provision only excludes (1) SEBI registered Category I and II Alternative Investment Funds (AIFs) and (2) Funds registered in GIFT IFSCA
	+ In this respect, second proviso to S.56(2)(viib) empowers Central Government to notify companies which are outside the scope of the provision. Accordingly, vide CBDT Notification No. 13/2019, CBDT has notified start-ups who fulfil conditions enumerated in DPIIT Notification No. 19 Feb 2019 and who have filed declaration in Form 2 as being eligible entities outside scope of S. 56(2)(viib). This carve out is very restrictive and applies only to small start-ups (Turnover < Rs. 100 Cr + Aggregate of Share Capital & Premium < Rs. 25 Cr) and which are less than 10 years old. Share capital cap of Rs. 25 Cr excludes issue of shares to non-residents & frequently traded listed companies**.** One of the conditions under DPIIT Notification No. 13/2019 is that the start-up company is restricted from investing in enlisted non-qualifying assets[[4]](#footnote-5) within 7 years from the end of the latest financial year in which shares are issued at premium (i.e., end-use condition).
* **Proposed amendment**
	+ FB 2023 proposes to extend the operation of S.56(2)(viib) to non-residents as well. Hence, where a CHC issues shares to non-residents for a consideration in excess of FMV of shares, the excess premium shall be taxable in hands of company.
	+ This makes the provisions of S.56(2)(viib) applicable for receipt of consideration for issue of shares at high premium from any person irrespective of the residential status.
* **Issue**
	+ In order to widen the scope of anti-abuse provision, S.56(2)(viib) has been made applicable to non-residents. The intent of provision of S.56(2)(viib) is to prevent money laundering whereby funds are infused into the company of the intended recipients by camouflaging the payment through inflated share premium accounts. The amount paid is disproportional to the inherent value of the company and in the process effective control of funds is retained by ‘a set of’ existing shareholders who may have major voting / participating stake.
	+ It is common for Indian companies at nascent and growth stage to raise funds from overseas investors. Such funds are generally used for bona fide business purpose.
	+ In case of start-ups, it is common practice for companies to raise funds at high premium due to high value of intangibles. Such intangibles are usually hard to give an accurate value with a degree of subjectivity being involved. Such ambiguity led to cases where tax authority would invoke the taxation provisions u/s 56(2)(viib) in respect of the funds received.
	+ As a measure to address such ambiguity and boost the start-up sector, the legislature had provided exemption to start-ups from S.56(2)(viib) as elaborated above, provided they meet the end-use condition. The insertion of end-use condition acts as a safe harbour to ensure that the funds are used for bona fide purposes of business.
	+ But the section has been subject matter of persistent litigation – mostly on valuation. Tax Authorities have challenged projected cash flows in DCF based on hindsight knowledge of post issue lower cash flows.
	+ Also, subsequent rounds of funding raised at lower values have triggered challenge to valuations in the first round.
	+ CBDT had to issue to several instructions to clear pending cases in litigation.
* **Challenges of compliance for non-resident investors**
	+ New age businesses have innovative valuation models. The DCF method does not work since there are no free cash flows expected in the near term for such start-ups with new business models.
	+ Valuers also adopt comparable price method by looking at domestic or international comparables with appropriate discounting
	+ Higher premium is insisted by promoters to retain their control where capital base is small
	+ FEMA regulations prescribes floor price based on Category I merchant banker’s report as per any internationally accepted valuation methodology (generally DCF or comparable valuation) below which shares cannot be issued by the Indian company. On the other hand, for s.56(2)(viib) purposes, Income tax law prescribes cap at DCF value. There is no flexibility for marginal difference between valuation for FEMA and Income tax purposes. If the value is below DCF, FEMA compliance becomes a challenge whereas if the value is above DCF, the excess becomes taxable as income u/s. 56(2)(viib) in the hands of the company.
	+ It is common for start-ups to raise funds at short-intervals at differential valuation including down-rounds. Any differential valuation is likely to trigger s.56(2)(viib) inquiry for higher valuations.
	+ Since FEMA prescribes floor price, promoters and NR investors agree for higher value for convertible instruments with variable conversion ratio such that the floor price condition can be met even if conversion results into higher number of shares. If FMV as per Rule 11UA at the time of conversion is higher, it can trigger s.56(2)(viib) taxation.
	+ In many cases, non-resident investors agree for investment in tranches. Hence, there could be situations where initial tranches are before amendment of s.56(2)(viib) and subsequent tranches (even though at same price) are after amendment of s.56(2)(viib). The post amendment tranches may face difficulty on valuation despite being made as per commitment made prior to the amendment.
	+ There could also be cases where convertible instruments (like Compulsorily Convertible Debentures or Compulsorily Convertible Preference Shares) are issued prior to amendment but get converted post amendment at exchange ratio fixed prior to amendment. Such conversions post amendment may also face difficulty of valuation dispute.
* **Adverse impact of amendment**
	+ There will be increased litigation on valuation disputes since majority of funding in start-ups is from non-residents
	+ The existing carve out for DPIIT registered start-ups is very restrictive and will cover only small number of small start-ups. Hence, non-resident investments in large startup or private investment in other companies (including in holding-subsidiary or group relationships) is likely to be prone to litigation on valuation u/s. 56(2)(viib)
	+ The amendment will prevent genuine Indian entrepreneurs involved in new age businesses from commanding high premium from non-resident investors and adversely impact Foreign Direct Investment into India.
	+ The amendment will encourage Indian start-ups to move overseas for funding since other countries (including developed countries like US, UK, Canada, and Australia) do not have such angel tax provisions.
* **Recommendations**
	+ Ever since its introduction, s.56(2)(viib) has been subject matter of persistent litigation. Although it is intended to be an anti-avoidance provision, it has adversely impacted many bona fide investments. There are other anti-avoidance provisions which adequately deal with the tax avoidance. S.68 provides for punitive rate of 60% for unexplained cash credits. S.50CA provides for minimum floor price for transfer of shares of unlisted companies. S.56(2)(x) provides for taxation of receipt of shares at less than FMV computed at Rule 11UA value. S.56(2)(viib) does not provide any profit linked deduction which have any concern on loss of revenue. Hence, our primary recommendation is to omit s.56(2)(viib) from the Act. This will bring parity between investments by residents and non-residents in closely held companies.
	+ Without prejudice to our primary recommendation to omit s.56(2)(viib), the following alternative measures may be considered to protect bona fide investments by non-residents from valuation dispute u/s. 56(2)(viib)
	+ Recently, SEBI issued Circular dated 9 December 2022 liberalizing foreign investment in AIFs by permitting investment by foreign investor who is a resident of the country whose securities market regulator is a signatory to the International Organisation of Securities Commission’s (IOSCO) Mulitilateral Memorandum of Understanding or a signatory to the bilateral Memorandum of Understanding with SEBI. It also prohibited investment by a resident of a country identified in the public statement of Financial Action Task Force (FATF) in “grey list” and “negative list”. The “grey list” includes countries which have deficiencies in their anti-money laundering laws but are under watch for progress and “negative list” includes countries which have not addressed such deficiencies or has not committed to an action plan developed with FATF to address such deficiencies. Taking clue from above, the following classes of non-resident investment may be exempted from application of s.56(2)(viib) :-
1. Government may provide specific exemption from section 56(2)(viib) to non-resident entities registered with RBI/ SEBI equivalent regulatory authorities in their respective countries or coming from FATF jurisdictions which are not under increased monitoring (‘grey list’’) or high-risk jurisdictions (‘blacklist’)
2. Exemption may be provided to investments by entities/ funds qualifying as Category I Foreign Portfolio investors under SEBI FPI Regulations 2019, even if not registered with SEBI
3. Exemption may be provided to direct/ indirect investment by sovereign wealth funds and pension funds qualifying as per definition u/s. 10(23FE) even if not notified as “specified person” u/s. 10(23FE)
4. Other criteria which may be considered for exempting NR investments are as follows :-
	* + - Endowments associated with hospitals, universities, and charities
			- Private Equity Funds, Venture Capital Funds, Hedge Funds wherein the fund or manager is regulated by financial services regulators recognized by IOSCO
			- Accredited Investors as per the manner specified by financial services regulators recognized by the IOSCO
	* Liberalize DPIIT norms as per 2019 Notification but limited to exemption from angel tax u/s. 56(2)(viib) to
5. remove the condition of turnover not exceeding Rs. 100 Cr – this condition will continue for profit linked tax holiday u/s. 80IAC since it is prescribed in s.80IAC itself as also for other regulatory purposes.
6. relax aggregate limit of INR 25 Cr in the share capital and share premium; and
7. liberalize end use conditions for not investing in loans and advances or capital contribution to other entity or shares & securities to permit use for bona fide business purposes like granting loans to employees or acquiring other businesses through share acquisitions or mergers/demergers and/or for temporary deployment of funds in mutual funds pending use for business purpose
	* Modify Rule 11UA(2) on lines of Rule 11UA(1)(c)(c) to permit valuation by Category I merchant banker under any internationally accepted valuation methodology – but this will protect only those cases where DCF value is lower than FEMA value.
	* Safe harbour mechanism/ tolerance limit upto 25% may be provided where shares are issued at a price higher than valuation report by Category I merchant banker
	* The above measures will ensure that the Indian companies are able to raise funds from genuine sources for bona fide business purposes without any hassles of establishing FMV or substantiating value to tax authority. It shall reduce the dispute over valuation and avoid unnecessary litigation.
	* To give true prospective effect to the amendment, it may also be clarified that the provision will not apply to conversion of convertible instrument (like CCDs or CCPS) into shares on or after 1 April 2023 where the convertible instrument was issued prior to 1 April 2023.
 |
|  | **Recommendations on the proposed amendments for Offshore Derivative Instruments (ODI)** | * **Existing provision**
	+ IBUs in IFSC (IFSC Banking Units) are permitted to issue Overseas Direct Investments (ODIs). The income attributable to the investment division of the IBUs (which has been granted a Category I FPI registration) is taxable as under:
1. Exempt Income - Income specified under section 10(4D) of the Act.
2. Income taxable under section 115AD of the Act - Income from securities [not covered under section 10(4D) of the Act] and capital gains on transfer of equity shares in a company resident in India
	* In respect of the ODIs issued by the IBUs, section 10(4E) of the Act was inserted by Finance Act 2021 which provides an exemption to non-residents in the case of ‘transfer’ of ODIs entered with an IBU.
	* However, income distributed by IBUs to ODI holders (otherwise than by transfer of ODI) could currently be subject to tax in the hands of ODI holders – leading to double taxation.
* **Proposed amendment and issues**
	+ Finance Bill 2023 proposes to remove the above double taxation on income received by non-resident ODI holders by extending the exemption to any income distributed by IBUs on such ODIs - where such income is chargeable to tax in the hands of the IBU (under section 115AD of the Act). The proposed provisions of section 10(4E) of the Act have been reproduced below:

*(4E) any income accrued or arisen to, or received by a non-resident as a result of––* *(i) transfer of non-deliverable forward contracts or offshore derivative instruments or over-the-counter derivatives; or* *(ii) distribution of income on offshore derivative instruments,* *entered into with an offshore banking unit of an International Financial Services Centre referred to in sub-section (1A) of section 80LA, which fulfils such conditions as may be prescribed:* *Provided that the amount of distributed income referred to in sub-clause (ii) shall include only so much of the amount which is chargeable to tax in the hands of the offshore banking unit under section 115AD.”** + As per the proposed provisions of section 10(4E) of the Act, in case of distribution of income to ODI holder, an exemption to the ODI holders shall be available only on so much of the amount distributed which is chargeable to tax in the hands of the IBU under section 115AD of the Act.
	+ However, in scenarios where income is distributed to ODI holders out of income that is not subject to tax in the hands of the IBU [on account of exemption provided under section 10(4D) of the Act], the income shall become taxable in the hands of the ODI holders on account of non-satisfaction of the conditions prescribed under proviso to section 10(4E) of the Act proposed to be inserted by Finance Bill, 2023.
	+ The above scenario could arise where the IBU has issued ODIs to non-residents ODI holders against investments in securities– the income from which is exempt under section 10(4D) of the Act.
	+ The tax treatment provided to units of an IFSC registered as an FPI is akin to the tax treatment provided to an entity based out of Singapore or Mauritius with respect to their investments in Indian securities, securities listed on IFSC exchange and investment in global securities.
	+ The ODI holders of FPIs based in Singapore or Mauritius currently do not suffer any taxes in India. The burden of discharging any tax liability within the ambit of the provision of the Act / Tax Treaty is solely on the Singapore / Mauritius based FPIs.
	+ Introduction of the proviso to section 10(4E) of the Act shall lead to FPIs set-up in IFSC being at a disadvantage vis-à-vis FPIs investing from Singapore / Mauritius. The additional compliance burden in the hands of the ODI holders (in absence of an express exemption) shall make this proposition highly un-attractive.
* **Recommendation**
	+ In order to provide the same tax treatment to non-resident ODI holders holding ODIs in offshore locations and those holding ODI in IBU and to bring the ODI business to IFSC in India from offshore jurisdictions, exemption should be provided to the non-resident ODI holders in respect of all incomes distributed by the IBU on the ODI contracts whether or not the income remain taxable in the hands of the IBU.
 |
| **Tax Deduction/ Collection at Source** |
|  | **Enable tax withholding u/s 192 on salary based on whether or not employee opts for concessional new regime** | * **Existing provisions**
	+ Finance Act 2020 introduced a new and simplified concessional tax rate (CTR) regime for individuals and HUFs who forgo certain deductions and exemptions under s. 115BAC of the ITA. S.115BAC provides for a reduced slab rate where taxpayer exercises his option annually to fall within purview of S.115BAC (in cases where the individual/ HUF has business/ professional income, such option can be exercised only once in the taxpayer’s lifetime and if revoked, subsequently cannot be exercised again. However, opt-in to the new CTR regime may be possible once business/profession ceases).
	+ S. 192 of the ITA places the obligation on employer to withhold taxes in respect of the salary income of the employee at the rates specified in the First Schedule of the annual finance bill. For this purpose, S.2(9) of the annual Finance Act which prescribes the taxation rate for individuals does not expressly cover the CTR regime u/s 115BAC.
	+ In this regard, CBDT Circular No. C1 of 2020 dated 13 April 2020 had noted that since the employees (not earning any income from business or profession) can exercise the option along with return of income, the employer, at the beginning or during the tax year is not aware whether the employees would opt for new CTR regime. In such case, the Circular requires employee to furnish intimation to employer of availing benefit u/s. 115BAC(1). In absence thereof, the employer is required to withhold tax at normal tax rate.
* **Proposed amendment**
	+ FB 2023 has amended the CTR Regime through introduction of sub-section (1A) therein whereby the CTR regime is proposed to be the default tax regime applicable to a taxpayer, unless he opts out of the same.
	+ Nonetheless, S.2(9) of FB 2023 continues to require the employer to deduct tax at source u/s. 192 at the rates as specified in Part III of the First Schedule which does not expressly cover the CTR regime u/s 115BAC.
* **Issue**
	+ While the choice opted by the employee directly impacts his tax liability on salary income, as explained above, given that S. 2(9) of FB 2023 does not refer to the CTR Regime u/s 115BAC, the salary tax withholding is still required based on old regime (despite S. 115BAC being the default tax regime).
	+ This is in conflict with provisions pertaining to payment of advance tax which permit an individual (including an employee) to remit taxes as per the reduced slab rates under the CTR Regime. This gives rise to ambiguity whether the employer shall be required to deduct tax at higher slab rate under old regime as compared to slab rate under new CTR regime.
	+ If the employer is precluded from considering the lower tax rates u/s. 115BAC(1A), it will result in higher withholding and consequent refund claims in the return. Such blockage of funds in the form of taxes leads to reduction in employee’s disposable income and hence defeats the object of introducing the lower tax regime.
	+ The issue may be further compounded since, the employee who is keen to opt for lower tax regime u/s. 115BAC(1A) will not furnish any evidences to the employer to claim any deductions (under say S. 80C, etc.) in absence of which the employer will consequently be required to deduct even higher tax under the old regime than he would have otherwise deducted after considering exemptions and deductions.
	+ To avoid this, employees may be necessitated to furnish the evidence to the employer to avoid higher withholding resulting in defeat of the very purpose of introducing a simpler regime where employee is not required to maintain or furnish any evidence.
	+ It is submitted that there is no revenue loss if the employer is permitted to consider benefit of the s.115BAC CTR Regime at the time of withholding. This is because the employee is unlikely to switchover to old slab rate in his return if s.115BAC(1A) is more beneficial. If the normal tax regime is more beneficial than s.115BAC(1A), the employee will be required to recompute his income in return of income and claim refund. Hence, there may practically be no case where the employer’s salary TDS will fall short of actual tax liability of employee on salary income.
* **Recommendation**
	+ It is hence recommended that a suitable amendment may be made in S.2(9) of FB 2023 in order to enable the employer to deduct tax as per S.115BAC(1A) which is now a default slab rate for all individuals or under old regime, as per option exercised by the employee at the beginning of the financial year.
	+ It is also suggested that CBDT should issue a clarification similar to CBDT Circular C1 of 2020 to enable the employer to deduct tax u/s. 192 at slab rates specified under new regime u/s.115BAC(1) unless an option has been exercised by employees to apply the old taxation regime.
 |
|  | **Extend non-applicability of punitive rate of deduction of tax at source in case of non-filers of return of income to TDS under s.194BA** | * **Existing provisions:**
	+ S. 206AB are non-obstante provisions which provide higher rates for TDS in case of payment made to ‘Specified Person’ (SP) who satisfies the following criteria cumulatively:
1. Who has not filed ITR for the financial year (preceding FY) immediately preceding the financial year in which tax is required to be deducted or collected (current FY) and for which the time limit to file ITR u/s. 139(1) has expired; [ROI condition] and;
2. The aggregate amount of TDS and TCS in his case is INR 50,000 or more in the preceding FY [Threshold condition]
	* The rate of TDS prescribed under s.206AB is higher of the following:
3. at twice the rate specified in the relevant provision of the Act; or
4. at twice the rate or rates in force; or
5. at the rate of 5%.
	* Presently, higher rate of TDS under s.206AB is not applicable in case where TDS is required to be deducted under certain sections which includes TDS on winnings from games under S. 194B and TDS on winnings from races under S. 194BB where TDS is to be deductible at rates in force which is 30%
* **Proposed amendment:**
	+ FB 2023 proposes to amend s.194B to exclude winnings from online games from its purview w.e.f. 1 July 2023 and introduce new s.194BA for TDS on net winnings from online games.
	+ S.194BA proposes that any person responsible for paying to any person any income by way of winnings from any online game during the financial year shall deduct income-tax on the net winnings in his user account, computed in the manner as may be prescribed, at the end of the financial year at the rates in force (i.e., 30%)
	+ FB 2023 also proposes to introduce new S. 115BBJ which states that net winnings from online games will be taxed at the rate of 30%
* **Issue**
	+ Punitive rate of TDS under s.206AB is not applicable when TDS is to be deducted on winnings from games or racesunder s.194B/s.194BB where TDS rate is 30%. While TDS for winnings from online game is proposed to be moved from S. 194B to S. 194BA, similar carve out from applicability of punitive rate of TDS under s.206AB has not been proposed for TDS under S. 194BA where also TDS rate is 30%.
	+ Hence, if a person qualifies as a ‘specified person’ and has income by way of winnings from online games, TDS will be deducted at the rate of 60% as per s.206AB (twice the rates in force). Such high TDS rate may be unjustified where special rate of tax under proposed S. 115BBJ for winnings on online game itself is limited to 30%
* **Recommendation**
	+ The list of exceptions listed in s.206AB(1) indicating non- applicability of punitive rate of TDS under s.206AB be expanded to include TDS under s.194BA. This would ensure that the maximum rate of TDS under s.194BA remains capped at 30% in all circumstances. Further, this would also ensure that parity between TDS on online game and offline games.
 |
|  | **Clarify that write off of trade debts does not attract TDS under S.194R** | * **Existing provision**
	+ S.28(iv) brings to tax value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession. This provision has existed in the Act since A.Y. 1964-65.
	+ FA 2022 introduced S.194R mandating a person responsible for providing any benefit or perquisite to a resident arising from the business or profession carried on by such resident to deduct tax at the rate of 10% of the value or aggregate value of such benefit or perquisite. The proviso to s.194R provides that if the benefit or perquisite is provided wholly in kind or partly in cash & partly in kind but the cash component is not sufficient to meet the TDS on whole of the benefit, then the provider should ensure that tax required to be deducted is paid.
	+ FAQ 1 of CBDT Circular No. 12 of 2022 dated 16 June 2022 clarified that the provider of benefit or perquisite is not required to ascertain taxability of benefit in the hands of recipient whether it is taxable under S.28(iv), S.41(1) or any other section. FAQ 2 clarified that s.194R covers cash benefits also. FAQ 3 thereof while clarifying that s.194R can also cover capital assets gave an illustration of principal amount of loan waiver under One-Time Settlement (OTS) by referring to CIT v. Ramaniyam Homes (P) Ltd – (2016)(68 taxmann.com 289)(Mad)
	+ But subsequently, FAQ 1 of CBDT Circular No. 18 of 2022 dated 13 September 2022, in case of waiver of loan, notes that saddling the banks with an obligation to withhold taxes on OTS, would cast an additional burden on the banks to pay additional amount in the form of taxes which are required to be withheld in addition to the haircut already suffered on account of loan waiver. In order to remove such difficulty, the CBDT Circular clarifies that withholding under S.194R will not be applicable to waiver of loan granted on one-time loan settlement by 10 categories of financial institutions. The FAQ further clarifies that exemption from TDS would not impact taxation in the hands of the borrower.
* **Proposed amendment**
	+ It is proposed to amend S.28(iv) and S.194R to clarify that provisions would apply to any benefit or perquisite, whether in cash or in kind or partly in cash and partly in kind.
* **Issues**
	+ The above referred amendment creates ambiguity for write off of trading debts and loans & advances (even by 10 categories of financial institutions who are exempted from TDS u/s. 194R by FAQ 1 of Circular No. 18/2022)
	+ Both s.28(iv) and S.194R imply that there is intent on the part of giver of benefit to provide benefit to the other person. It should be a voluntary gesture or a contractual obligation on the part of giver. However, bad debt write off of trading debts is more often than not a unilateral action on part of the creditor due to compulsive circumstances – more particularly, since s.36(1)(vii) grants bad debt deduction only upon write off in books of account. The right of creditor to recover the amount from debtor continues in which case there is no benefit to debtor as its liability towards creditor continues. Even in case of bad debt write off through negotiated settlement, such settlements are usually entered to settle disputes and move ahead in life and not with a view to grant any benefit or perquisite to the debtor.
	+ The above proposed amendment also has an unintended and far-reaching impact on resolution of companies which are undergoing under Corporate Insolvency Resolution Process (CIRP) under Insolvency and Bankruptcy Code 2016 (IBC), and currently awaiting an order from the National Company Law Tribunal (NCLT) and all companies where lenders / banks / financial institutions / creditors contemplate to take the distressed companies where lending institutions are saddled with large NPAs. Under the IBC proceedings, after following due process, a corporate lender is able to recover part of its debts from a new buyer who is willing to take over the distressed company which has defaulted its financial obligations. As an outcome of IBC proceedings, the lenders (including sundry creditors, operational creditors, government dues, employee, and workmen dues, etc.) take a haircut on outstanding dues, and settle their dues at an amount as approved by NCLT submitted by the highest bidder and validated by Committee of Creditors (COC).
	+ Pursuant to which, there is write back of loan debts in the books of account of the distressed company for the portion of liability, which is no longer payable to its lenders. At present, this benefit in cash is not covered by the scope of Section 28(iv) of the Act which is upheld by various courts and tribunals [including the Hon’ble Supreme Court in Mahindra and Mahindra (93 taxmann.com 32)]. However, with the proposed amendment, there is apprehension that the above write backs would fall within the scope of Section 28(iv) of the Act and will attract huge tax liability on corporate debtor / distressed company.
	+ In view of above background, it is important to remember the object of IBC, that is to rescue the corporate debtor by bringing a new buyer by settling all the debts of a distressed company, which otherwise would never get paid and lead to liquidation of the company, loss of employment, huge loss to lenders and ultimately adversely impact the industrial development. Hence, if such write back of loan liabilities are taxed as business perquisite income in the hands of the distress company (which is under the control and management of new buyer), it will defeat the object of IBC, as it will decrease the settlement amount as approved by NCLT to the extent of tax on such write backs, which will lead to a reduction in recovery made by the lenders.
	+ Further, if the above is proposed to be taxed, the new buyer would factor the tax cost on the write backs in the offered price of one-time settlement, and ultimately it would be injustice to the lenders who are anyways at the receiving end of accepting write offs of their dues and further reduction in settlement price would dampen their hopes in the IBC process and restructuring of debts.
	+ It is also important to note that here the benefit of writeback of liabilities to a distressed company is not a unilateral or bilateral act as per mutual understanding between the parties. It is basis the resolution plan submitted by various bidders and upon recommendation of COC, NCLT approves the plan, and as per the approved plan, the new buyer discharges the agreed consideration towards full and final settlement of dues of the distressed company. In fact, it is a benefit granted under the operation of provisions of the IBC and the distressed company is under obligation to follow the same. Thus, the same cannot be brought to tax as it would not give a fair deal to the new buyer which has intention to revive the distressed company
* **Recommendations**
	+ The proposed amendment should be dropped.
	+ Alternatively, a suitable clarification may be provided that capital receipts are not covered within the scope of the section.
	+ Separately, it is recommended to clarify that withholding under S.194R is not required on write off of bad debt by creditor. It is recommended that similar relaxation as provided under CBDT Circular No. 18 of 2022 w.r.t. one-time settlements by specified financial institutions, may be extended to write off of trade debts both u/s. 28(iv) and s.194R.
	+ An exception under Section 28(iv) should be provided for not taxing the loan written back as a result of resolution plan under IBC as approved by NCLT as ‘cash benefit / perquisite’
	+ It should also be clearly stated that merely because another taxpayer has deducted TDS u/s 194R on certain payments may not be subject to tax in the hands of recipient.
 |
|  | **Omit the proposal to increase rate of TCS for remittances made under LRS, overseas tour package [206C(1G)]** | * **Existing provision**
	+ **Section 206C(1G) was inserted vide the FA 2020 to provide TCS as under:**
1. Authorised Dealer to collect TCS @5 % from a person making remittance outside India under RBI’s Liberalised Remittance Scheme (buyer). TCS collectible only if the remittance crosses threshold of INR 7 lakh in a FY
2. Tour operator i.e. seller of overseas tour package to collect TCS @5% from the buyer. No monetary threshold applies in this case.
3. TCS of 0.5% applies where remittance (exceeding 7 lakhs) is out of an education loan taken from any financial institution under S. 80E.
* **Proposed amendment**
	+ FB 2023 proposes to increase rate of TCS from 5% to 20% for remittance made under LRS and payments for overseas tour package,
	+ Also, threshold limit of INR 7L is removed for remittance under LRS Scheme.
	+ Exception continues for remittance made for the purposes of education or medical treatment which is subject to threshold limit of INR 7L and TCS rate is 0.5% if remitted out of loan obtained from s.80E financial institution**.**
* **Issues**
	+ There is no specific reason provided in Exp Memo for increase in TCS rate. For honest taxpayers, LRS represents own tax paid monies. The foreign assets (like investments, property, etc.) purchased through LRS are required to be reported by resident taxpayer in Schedule FA of ITR and any default on reporting foreign income/assets is amenable to adverse consequences under Black Money Act.
	+ If the decision to increase the TCS rate has been motivated by observed cases of LRS remittances made by persons not having sufficient means, then the solution does not lie in increasing TCS rate which casts more burden on the honest taxpayers. Rather the information generated from 5% TCS reporting ought to be investigated further and undisclosed incomes should be taxed in the hands of the defaulter at 60% u/s. 115BBE. The honest taxpayers will face burden of higher TCS whereas dishonest persons will resort to other illegal means to remit monies outside India.
	+ Further, presently there is no mechanism in the law for the employer to consider TCS suffered by the employee for adjusting the Salary TDS. This creates cash flow issue for the employee till processing of his return u/s. 143(1).
	+ There is also an ambiguity on 5% TCS rate for remittances under LRS for the purposes of medical treatment and education. Such remittances are not only to foreign hospitals or foreign universities but also include remittances for boarding & lodging expenses of the individual and/or relatives during such medical treatment or education. Presently, there are different purpose codes provided under LRS for medical, education, travel, and family maintenance but all suffer same TCS rate. Post amendment, classification under different purpose codes will become very pertinent. The authorized dealers may face classification disputes with Tax Authorities due to differential TCS rates. It will cast onerous burden on the authorized dealers if they are expected to conduct due diligence and obtain appropriate evidence in support of remittances for medical treatment and education instead of simply relying on self-declarations.
	+ In non-PAN cases or non-return filers, s.206CC/s.206CCA requires TCS at higher of twice the specified TCS rate or 5%. With increase in TCS rate on LRS to 20%, the higher rate u/s. 206CC/206CCA will be 40% which is much more highest tax slab rate of 30%.
* **Recommendations**
	+ The proposed amendments may be dropped, and status quo ante may be retained. This is particularly because TCS on LRS remittance is a tax collected on tax-paid monies and not on taxpayer’s income. The amendment adversely impacts honest taxpayers whereas dishonest taxpayers will resort to other illegal means to avoid such tax burden.
	+ Without prejudice, presently there is no mechanism in the law for the employer to consider TCS suffered by the employee for adjusting the Salary TDS. Hence, s.192 may be amended or it may be clarified through a Circular to facilitate the employer to consider the TCS suffered by employee.
	+ Furthermore, an amendment is required to section 206CC and s.206CCA to cap the rate at 20% from the existing rate of 10%.
 |
|  | **Expand scope of section 197 to other TDS provisions** | * **Existing provision**
	+ Provisions of section 197 empower the tax authority to issue a certificate on application by the taxpayer, whereby tax can be deducted at NIL or specified reduced rate by a payer on payments made to the recipient taxpayer.
	+ Presently, section 197 specifies a list of payments/ credits on which tax shall be deducted/ withheld at lower/ nil rates as compared to the rates specified in the main TDS provision. However, such list is not exhaustive and does not cover various tax withholding provisions under the ITA such as S. 194LBA (TDS at 5% by business trust on interest income of non-resident unit holders), s.194IA (TDS on immovable property), s.194R (Business perquisites), etc.
* **Proposed amendment**
	+ The Finance Bill 2023 proposes to insert reference to section 194LBA in section 197.
	+ Hence, in light of the amendment, wherever the income earned by the unit holder from the business trust was exempt or where the total income of the taxpayer justifies deduction of tax at lower rates/ nil rate, the recipient taxpayer can make an application under section 197.
* **Issue**
	+ While proposed amendment to section 197 has made a reference to section 194LBA, however, as enumerated above there are other sections also which are not covered by section 197.
	+ For instance, provisions of section 194-IA (TDS on immoveable property) provide for withholding of taxes in case where the consideration payable for transfer of immoveable property or stamp duty value of such property is higher than Rs. 50 Lakh. In absence of any reference to section 194-IA in section 197, the payer is required to withhold taxes even if the taxable income arising on such capital gains is less than the maximum income not chargeable to tax.
	+ This issue may be especially compounded in cases where a borrower’s immovable property, held as security for debt issued by the lender, is sold by such lender on failure of borrower to repay the debt. Tax withholding in such case only results in reduced recovery in respect of a secured debt in favour of payment of taxes (which incidentally under the Insolvency and Bankruptcy Code has lesser priority under the waterfall mechanism).
	+ Similarly, even S. 194R (TDS on business perquisites) is not covered by S. 197.
	+ Additionally, there is no comparable provision for non-collection of taxes u/s 206C of the ITA.
* **Recommendations**
	+ The application submitted by the taxpayer under section 197 is subject to verification by tax authority u/s. 197(1). Hence, S. 197 may be extended in application to all TDS and TCS provisions under Chapter XVII of the ITA to apply wherever the tax authority is satisfied regarding the validity of the claim of the recipient taxpayer, the certificate of lower/non deduction/ collection of tax of tax may be issued.
	+ This will ease cash flow crunch of taxpayer and facilitate ease of doing business.
 |
|  | **Relaxation from punitive TDS/TCS rates [S. 206AB/ 206CCA] be expanded** | * **Existing provision**
	+ S. 206AB/s. 206CCA are a non-obstante provisions which provide higher rates for TDS/ TCS in case of payment made to ‘Specified Person’ (SP) – intended to improve ROI filing compliance by non-filers
	+ **SP means a person who satisfies the following criteria cumulatively:**
1. Who has not filed ITR for the financial year (preceding FY) immediately preceding the financial year in which tax is required to be deducted or collected (current FY) and for which the time limit to file ITR u/s. 139(1) has expired; [ROI condition] and;
2. The aggregate amount of TDS and TCS in his case is INR 50,000 or more in the preceding FY [Threshold condition]
	* Presently, definition of SP excludes a non-resident who does not have a permanent establishment in India
	* Further, CBDT Circular No 10/2022 dated 17 May 2022 also grants relaxation from strict application of the provision. If payee/payer is indicated as not a SP at beginning of the year, he can be treated as non-SP for whole of the year even if fails to furnish ROI for immediately preceding previous year by due date of filing ROI falling within current year.
* **Proposed amendment**
	+ Explanatory Memorandum acknowledges that there are certain persons who are not required to file tax return in India and such persons are not intended to be treated as a non-filer of tax return
	+ As a rationalization measure, S. 206AB, 206CCA is proposed to be amended to exclude a person who is not required to furnish the return of income for the preceding FY and who is notified by the Central Government in the Official Gazette in this behalf.
* **Issue**
	+ Making the relaxation conditional to Notification appears unreasonable - If taxpayer is not required to file ROI under the ITA, the intention of not applying punitive rates will be satisfied. Thus, amendment has no effect unless some Notification is issued.
* **Recommendations**
	+ Where an exemption to file return of income is provided under the Act itself, such taxpayers should be automatically relieved from punitive rates of TDS and TCS E.g., NR covered by S. 115A(5), 115AC(4) subject to TDS under S. 195. Such relaxation provided in the Act should not be subject to notification issued which will be an additional administrative act.
	+ Further, notification may be used as an additional method to exclude persons other than those stated above, who are otherwise exempt from filing return under ITA.
 |
| **Personal Taxation** |
|  | **Seeking a proper valuation base for housing accommodation perquisite valuation [S. 17(2)(i)/(ii)]** | * **Existing provision**
	+ S.17(2)(i) provides for taxation of rent-free accommodation (RFA) provided by employer as “perquisite” in the hands of the employees. Valuation of RFA is governed by Rule 3(1) of the Income-tax Rules.
	+ S.17(2)(ii) provides for taxation of accommodation provided at a concessional rate (Concessional accommodation) by the employer as perquisite in the hands of the employees. Explanation 1 to 4 to S.17(2)(ii) creates a deeming fiction in respect of concessional rent to arise where rent recovery is less than specified rate. Where there is a concession due to the deeming fiction, valuation rules prescribed under Rule 3 becomes applicable.
	+ Existing valuation rule for employer owned accommodation is based strictly on percentage of salary. On the other hand, in cases like leased or hotel accommodation, the actual rent payable by employer is considered if lower than specified percentage of salary.
* **Proposed amendment**
	+ FB 2023 proposes to provide a uniform methodology for valuing the RFA perquisite and concessional accommodation perquisite. Hence with an intent to rationalize the provisions, S. 17(2)(i) and (ii) are amended to empower the Government for prescribing rules of valuation of RFA and Concessional Accommodation Perquisite
* **Issue**
	+ The present Rule 3 valuation is linked to percentage of salary in case of employer owned accommodation and does not consider the fair rental value of the accommodation. Thus, the same accommodation may be valued at different values in the hands of different employees based on salary earned by them. This measure was introduced in 2001 to curb the litigation on fair rental value accommodation (which can be subjective).
	+ There may arise a situation where small accommodation provided to high salaried employee is taxed at higher rate whereas big accommodation provided to employee with low salary is taxed at lower rate.
	+ This creates a challenge for the Taxpayers and provides scope for tax planning.
	+ It is true that the constitutional validity of Rule 3(1) as amended in 2001 has been upheld by the Hon’ble Supreme Court in the case of Arun Kumar v. UOI [2006] 155 TAXMAN 659 (SC). Further, the SC held that perquisite would apply only if there were ‘concession’ in the matter of rent which is a jurisdictional fact to be established and there is no deeming fiction of ‘concession’ in the matter of rent. This was addressed by the Parliament by inserting Explanations 1 to 4 to s.17(2)(ii) by Finance Act 2007 with retrospective effect to deem the ‘concession’ to exist if the rent recovered from the employee is less than specified percentage of salary. Prior to its amendment in 2001, the erstwhile Rule 3(1) did reckon the ‘fair rental value’ of the accommodation as one of the factors for arriving at perquisite value for employees of private sector. The SC did note that the amendment was intended to simplify the perquisite valuation since computing ‘fair rental value’ of different properties was very cumbersome for private sector employees. Furthermore, the amendment was made based on recommendations of an expert group constituted to rationalize and simplify the tax laws.
	+ However, it is submitted that adverse implications of ‘simplification’ of the rule warrants a serious reconsideration of the valuation rule. The simplification has resulted in company owned housing becoming extremely tax disadvantageous as compared to HRA for employees in private sector discouraging employees in private sector from taking up company owned housing accommodation. Thus, the measure of ‘simplification’ has unintentionally resulted in inequitable and unfair tax treatment. Hence, the fact that constitutional validity of Rule 3(1) has been upheld by SC should not preclude a relook at equity and fairness of the rule.
* **Recommendations**
	+ It is prayed that the new valuation rules which are expected to provide for uniform methodology for perquisite valuation may address the above anomaly by considering alternative solutions. For instance, the annual fair rental value can be taken at 1% or 2% of stamp duty ready reckoner value instead of valuing it as a percentage of salary or basis fair rental valuation.
 |
|  | **Provide grandfathering for existing market-linked debentures issued before 1 April 2023** | * **Proposed Amendment**
	+ The impact of insertion of section 50AA is that all gains arising from transfer / redemption / maturity of market-linked debentures would be treated as short-term capital gains and are chargeable at applicable rates. The provisions of section 50AA are sought to be inserted w.e.f. 1 April 2024 i.e., AY 2024-25 and onwards.
* **Issue:**
	+ The proposed provision does not provide any carve-out to debentures issued prior to insertion of the provision. Accordingly, even where investment is made much prior to date of insertion of section 50AA, the gains arising on transfer / redemption / maturity may still be governed by section 50AA if the event of transfer / redemption / maturity is on or after 1 April 2023. The tax impact under section 50AA may adversely impact the returns to the investor basis which they would have invested in MLD.
	+ It is not a sound tax policy to change the tax treatment of financial instruments midway. The Legislature specifically provides for ‘grandfathering’ of existing financial instruments to ensure that taxpayers who invested therein on the basis of a particular tax treatment are not prejudicially impacted due to change in tax treatment.
	+ Even in Finance Bill 2023, although tax treatment for high premium life insurance policies is proposed to be changed, it is proposed to make it effective only for life insurance policies issued on or after 1 April 2023 and not for existing life insurance policies. Similar policy should be adopted for MLDs
* **Recommendation:**
	+ Suitable carve-out may be provided from applicability of section 50AA in respect of bonds issued prior to 1 April 2023.
 |
|  | **Remove anomaly in proposed amendment to s.54 in relation to determination of Cost of Acquisition of new residential house where transfer is within the limitation period of 3 years, actual cost of new house is more than INR 10 Cr and capital gains on sale of old house is more INR 10 Cr [S. 54]** | * **Existing provision**
	+ Section 54 provides capital gains exemption to individual and HUF arising from transfer of long-term capital asset (being buildings or land appurtenant thereto and residential house) where taxpayer has purchased one residential house property in India either 1 year before the transfer or 2 years after the transfer or constructed a house within 3 years (referred as New House) after such transfer.
	+ To illustrate, if the indexed cost of old residential house is Rs. 5 Cr and it is sold for Rs. 25 Cr, as per existing provision, it is possible for taxpayer to claim full LTCG exemption of Rs. 20 Cr by investing in another house costing at least Rs. 20 Cr within the prescribed time limit.
	+ As per section 54(1)(i), in case where such actual capital gains are more than cost of new residential house property purchased then capital gains chargeable to tax is the difference between actual capital gains and cost of new asset. Further, in case where such new asset is transferred within a period of 3 years then due to fiction created by section 54(1)(i), while computing capital gains, the cost of new house is taken as NIL. This is a claw back provision for not fulfilling the condition of exemption granted earlier.
	+ As per s. 54(1)(ii), in case where capital gains are equal to or less than cost of new house then in such case entire capital gains is exempt. Further, in case where such new asset is transferred within a period of 3 years then as per Section 54(1)(ii), while computing capital gains the cost of new house will be original cost as reduced by capital gain exempted earlier.
* **Proposed amendment**
	+ FB 2023 has proposed to insert third proviso to s. 54(1) which provides that in case the cost of new asset is greater than INR 10 Cr then for the purposes of this section, the cost of new asset is restricted to INR 10 Cr.
	+ To illustrate, if indexed cost of old residential house is Rs. 5 Cr and it is sold for Rs. 20 Cr, as per existing law, it is possible for taxpayer to claim full LTCG exemption of Rs. 15 Cr by investing in another house costing at least Rs. 15 Cr. But under the new regime, even if the taxpayer buys another residential house of Rs. 15 Cr or more, the capital gains exemption will be restricted to Rs. 10 Cr and he will be required to pay LTCG tax on balance gains of Rs. 5 Cr
* **Issue**
	+ There appears to be unintended lacuna in one scenario where the new house for which exemption is claimed u/s 54 is sold within 3 years. The lacuna exists in limited cases where LTCG is more than cost of new property.
	+ Continuing the above example, if the new house is purchased for Rs. 12 Cr, LTCG tax is paid on Rs. 2 Cr and the new house is sold within 3 years, due to operation of s.54(1)(i), the cost of new house is deemed to be NIL despite the fact that taxpayer has already suffered LTCG on Rs. 2 Cr. Logically, the cost of new house should be considered as Rs. 2 Cr (i.e., excess over Rs. 10 Cr) to avoid double taxation
* **Recommendations**
	+ A suitable amendment may be made in s.54(1)(i) to avoid the above referred unintended double taxation
 |
|  | **Treat proceeds of high premium life insurance policy as capital gains instead of Income from other sources and remove practical difficulty in identifying non-qualifying life insurance policy while deducting tax under S.194DA by life insurance companies** | * **Existing provision**
	+ **S.10(10D) provides that any sum received under a life insurance policy, including sum allocated by way of bonus on such policy shall be exempt, subject to certain specific exceptions:**
1. Amounts received under s. 80DD(3) – insurance policy for disabled dependent
2. Sum received under Keyman insurance policy
3. Insurance policy issued from 1 April 2003 to 31 March 2012 for which premium payable for any of the years during the term of the policy exceeds 20% of actual sum assured (except death benefit)
4. Insurance policy issued on or after 1 April 2012 for which premium payable for any of the years during the term of the policy exceeds 10% of actual sum assured (except death benefit)
5. ULIP issued on or after 1 Feb 2021 where the premium (or aggregate premium) payable for any of year the term of ULIP (or more than one ULIP) exceeds INR 2.50L (except death benefit) – treated as capital gains u/s. 45(1B) r.w. Rule 8AD
	* Under the existing provisions, barring ULIPs, there is no cap (in terms of absolute value) on the amount of annual premium being paid by any person during the term of the policy to claim exemption
	* However, several HNIs avail S.10(10D) exemption by investing in policies having large premium contribution (like investment policy)
* **Proposed amendment**
	+ FB 2023 has proposed to withdraw exemption in respect of life insurance policies issued on or after 1 April 2023, where the premium payable for any of the previous years during the term of such policies exceeds Rs. 5L and tax the proceeds from such policies under Income from other sources as per S.2(24)(xviid) r.w. S.56(2)(xiii). However, death benefit on such policies will continue to be exempt.
	+ Where a Taxpayer pays premium on multiple life insurance policies issued on or after 1 April 2023, exemption under S.10(10D) shall be applicable only to those policies where aggregate premium (of all policies) does not exceed INR 5L in any of the previous years during the ‘term’ of any of those policies.
	+ Since the payout from such insurance policies are now taxable, there will be corresponding withholding obligation on life insurance companies under S.194DA at 5% of net income from payouts of survival benefits.
* **Issue**
	+ Insurance policies are long term instruments generally extending over more than 10 years. While some of the products are simple endowment or moneyback policies, many products – especially those issued by new age private sector insurers - have distinct features which have investment features – even though they do not qualify as ULIPs. The insurance policies primarily give life risk protection and investment returns are secondary. They are not comparable to pure debt instruments like fixed deposits with banks or bonds/debentures. Hence, it is not appropriate to tax surplus received on non-qualifying life insurance policy as Income from other sources at full rate of tax without indexation benefit. It is more appropriate to treat such income as long-term capital gains where the policy is held for more than 3 years and accordingly tax the surplus as long-term capital gains either at 20% (with indexation benefit) or at 10% (without indexation benefit) consistent with off-market sale of listed shares.
	+ On withholding obligation u/s. 194DA, if the premium paid on individual policy exceeds INR 5L, there is no difficulty for life insurance company to identify it as non-qualifying policy and deduct tax on pay-outs of survival benefits thereon.
	+ However, if the premium on individual policy is less than INR 5L, the choice is with the policy holder to choose out of those multiple policies whose aggregate premium is less than INR 5L in a financial year to claim exemption u/s. 10(10D) and pay tax on other policies. This is supported by clarification given in Example 8 of Circular No. 2/2022 in context of ULIPs. For instance, an individual may take out 6 policies of Rs. 1 L each with different insurance companies and choose any five of them as qualifying u/s. 10(10D) and balance one as non-qualifying. Unless the taxpayer informs the life insurance company of his choice, it is not possible for life insurance company to identify such policy for TDS compliance u/s. 194DA.
* **Recommendations**
	+ The surplus received on non-qualifying life insurance policies should be taxed as long-term capital gains where the policy is held for more than 3 years either at 20% (with indexation benefit) or at 10% (without indexation benefit)
	+ It is recommended that an amendment shall be carried out to provide that no withholding shall be carried by the insurance company as such leads to an onerous obligation to determine the taxability of each policy holder which is practically difficult if not impossible. Alternatively, in order to avoid any default on the part of life insurance company, it may be provided that life insurance company is not liable to deduct tax on survival benefit payouts where the annual premium payable on the policy was less than Rs. 5 lakhs. The life insurance companies may be mandated to furnish information of such pay outs in annual statement of financial transaction u/s. 285BA
	+ Alternatively, the life insurance company may be required to consider only those policies for computing aggregate annual premium threshold of Rs. 5 lakhs which are issued by the same life insurance company to the same policyholder. In other words, a life insurance company need not consider policies taken out by policyholder from other life insurance companies.
	+ Alternatively, it is suggested to clarify a mechanism for policy holder to inform his choice to life insurance company, which the life insurance company can consider for deducting or not deducting tax u/s. 194DA. More specifically, the life insurance company should not be held to be in default if it bona fide relies on declaration given by the policy holder for not deducting tax even though it is discovered subsequently that the policy holder was not entitled to exemption u/s. 10(10D) on such policy.
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| **Procedural Aspects** |
|  | **The proposal to introduce the special cost audit of inventory under S.142(2A) may be dropped** | * **Proposed amendment**
	+ Finance Bill substitutes of S.142(2A) to empower the Assessing Officer to direct the taxpayer to get the valuation of inventory through ‘Cost Accountant’ having regard to following cases:
		1. Nature and complexity of the accounts,
		2. Volume of the accounts,
		3. Doubts about the correctness of the accounts,
		4. Multiplicity of transactions in the accounts or specialized nature of business activity of the taxpayer, and
		5. The interests of the revenue
	+ Assessing Officer can direct taxpayer to get valuation of inventory from Cost Accountant only with prior approval of Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.
	+ Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner are required to prescribe such Cost Accountant and also determine budgeted expense including remuneration of Cost Accountant.
	+ Cost Accountant is required to furnish valuation report duly signed and verified and setting forth such particulars in prescribed manner.
* **Issues**
	+ The amendment is proposed with objective of “prevention of permanent deferral of taxes through undervaluation of inventory”. Though intent behind such proposal is to prevent undervaluation of inventory but, it ends up with additional burden on taxpayers.
	+ Explanatory Memorandum to Finance Bill, provides that powers are entrusted to direct for valuation of inventories with an intent to “prevent permanent deferral of taxes”
		1. Taxpayer opting of mischief to avoid taxes, may undervalue its closing stock during the year and credit to the Trading or Manufacturing account.
		2. The undervalued closing stock will be captured as opening stock in the manufacturing or the trading account, in the next financial year and thus, will compensate for the understatement in previous year.
		3. Hence, there is no permanent deferral of taxes by taxpayer by undervaluation of closing stock.
	+ There are existing audits / certifications under different laws which deals with valuation of inventories:
		1. Companies are mandated by law to conduct a statutory audit of the financial statements as per Companies Act 2013 and Companies (Audit and Auditors) Rules, 2014.
		2. Cost Audit under section 148 of the Companies Act 2013 is also applicable to specified large Companies who are required to maintain their cost records and get the cost audit done by a Cost Accountant.
		3. Tax Audit - ICDS Reporting under clause 13(d) in Form 3CD includes ICDS II on valuation of inventory as well. As per ICAI’s guidance note on Tax Audit, para 26.4 it is clearly mentioned that the tax auditor should study the procedure followed by the assessee in taking the inventory of closing stock at the end of the year and the valuation thereof.
	+ Direction to conduct valuation of inventories by Cost Accountant under S.142(2A) may only pile up additional burden on taxpayers
	+ It may here be highlighted that the cost audit under S.148 of Companies Act 2013 and inventory valuation is the exercise being undertaken by the taxpayer during the financial years and immediately at the end of the financial year and it also involves a physical verification and stock taking exercise by the taxpayers.
	+ The Assessing officer may exercise its jurisdictions under S.142(2A) during the course of assessment of income (i.e., may be after 1 or 1.5 year from end of financial year). Since the physical inventory keeps on churning, it may be practically difficult for Cost Accountant to physically verify the closing stock and arrive at correct valuation. The Cost Accountant may need to rely on accounts and cost records prepared by taxpayer and cost auditor (especially in case of large manufacturing companies where physical inventory and its records may be stored pan India). Hence, even if jurisdiction under S.142(2A) is exercised by Assessing Officer, the desired intent may not fructify.
	+ Existing provisions of S.142(2A) which allows Assessing Officer to direct for special audit by Chartered Accountant, covers the valuation of inventory and ensure that it is in compliance with provisions of s.145A.
	+ The norms of valuation of inventory for accounting and tax purposes is different due to special provisions of s.145A and ICDS II which Chartered Accountant is better placed to verify and report.
* **Recommendations**
	+ It is recommended to omit the proposed amendment which fails to achieve desired intent.
	+ Without prejudice to the above, guidelines and principles for inventory valuation should be prescribed. A tolerance range of +-5% can be defined in case of mismatch in inventory valuation.
 |
|  | **Rewording S. 170A to cover continuing concerns and not just successor entities** | * **Existing provision**
	+ Section 170A of the ITA enables giving effect to the order of business reorganization issued by tribunal or court or an Adjudicating Authority under the Insolvency and Bankruptcy Code, 2016 by providing that, where a return of income is filed by a successor in respect of any AY, such successor shall furnish a modified return within six months from the end of the month in which such order of business reorganization was issued.
	+ In this regard, there were no further provisions to enable tax authority to modify its assessment in respect of such modified return.
* **Proposed amendment**
	+ FB 2023 proposes to amend S. 170A where it permits modified return filing by the successor where the return u/s 139 is filed by “an entity”
	+ Further, it also introduces enabling provisions for tax authority to finalize assessment based on such modified return by passing a modified assessment order.
* **Issue**
	+ There is scope for improvement in language of proposed s.170A on account of the following:
		1. Both prior and post amendment, S. 170A does not clearly cover modification of assessment of demerged company pursuant to NCLT order sanctioning demerger scheme.
		2. Further, it refers to resulting companies only whereby only a resulting company can file a modified return. This may preclude a demerged company from doing so which is intended.
* **Recommendations**
	+ For better clarity, it is suggested that the instead of terms “entity” (which is undefined under the ITA) and “successor” (defined to mean all resulting companies in business reorganization) may be substituted with “person” as follows:

“*170A. (1) Notwithstanding anything to the contrary contained in section 139, in a case of business reorganisation, where prior to the date of order of a High Court or tribunal or an Adjudicating Authority as defined in clause (1) of section 5 of the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as order in respect of business reorganisation), as the case may be, any return of income has been furnished by* ***a person*** *to which such order applies under the provisions of section 139 for any assessment year relevant to the previous year to which such order applies,* ***the person (or his successor)*** *shall furnish, within a period of six months from the end of the month in which the order was issued, a modified return in such form and manner, as may be prescribed, in accordance with and limited to the said order.*” |
|  | **Roll back or rationalize provisions regarding withholding of interest on refunds by revenue authorities [S. 245]** | * **Existing provision**
	+ The ITA has two separate provisions dealing with withholding of refund due to a taxpayer in certain specific circumstances as below:
1. S. 245 gives powers to the tax authority to withhold, vide an intimation, refunds due to a taxpayer where there already exists an unpaid demand determined in the case of the same taxpayer in respect of any year.
2. S. 241A gives powers to the tax authority to withhold refunds in respect of AY 2017-18 and subsequent AYs, vide a speaking order, where a notice has been issued u/s 143(2) in respect of the same AY for which the refund is determined u/s 143(1) and the tax authority believes that grant of refund is likely to adversely affect the revenue.
	* From the above, it may be noted that while refunds can be set-off against already existing demands of any year, set-off is permitted against prospective demands that may arise in case of pending proceedings only where the prospective demand relates to the same year to which the refund pertains, and the refund is determined u/s 143(1).
	* This proposition has also been upheld by the Bombay High Court (HC) in the case of Vodafone Idea Limited [2020] 117 taxmann.com 597 (Bombay) wherein it was observed that there is no power vested in tax authority to adjust/retain admitted refund against tax dues of another year which are not even adjudicated upon and may arise in future.
	* Separately, S. 244A(1) also prescribes for tax authority to pay interest on refund at 6% per annum (p.a.) from 1 April of the relevant AY till date of grant of the refund (where the refund arises out of excess TDS/ TCS/ Advance tax paid) qua refunds arising from a Giving Effect Order passed by a tax authority pursuant to the order of an appellate authority.
	* Such refund is enhanced vide S. 244A(1A) to 9% (viz. an additional interest of 3%) in case there is a delay beyond 3 months in the tax authority passing the Giving Effect Order. Such additional interest of 3% is payable from the expiry of 3 months till the date on which such refund is actually granted.
	* At this juncture it may also be worth noting the provisions of S. 234B of the ITA which requires a taxpayer to pay interest at 12% per annum from 1 April of relevant AY till date of completion of assessment on shortfall of advance tax as compared to assessed tax.
* **Proposed amendment**
	+ FB 2023 proposes to consolidate the existing provisions of S. 241A and S. 245 into a new S. 245 where:
1. Sub-section 1 will be at par with old S. 245 whereby tax authority may withhold refunds due to a taxpayer against an already existing unpaid demand determined in the case of the same taxpayer in respect of any year.
2. Sub-section 2 whereby the existing provisions of S. 241A are expanded and powers are given to the tax authority to withhold refunds due to the taxpayer in respect of any AY if proceedings of assessment or reassessment for any AY are pending in the case of the same taxpayer and the tax authority believes that grant of refund is likely to adversely affect the revenue.
	* In other words, withholding of refund on pendency of proceedings which was earlier restricted only to pendency of proceedings in respect of the same AY (being after AY 2017-18) where refund was determined u/s 143(1), is now proposed to be permitted in respect of pendency of assessment or reassessment proceedings of any other AY too irrespective of the proceedings in which the refund is determined.
	* Further, S. 244A(1A) is also proposed to be amended vide introduction of a proviso to state that additional interest at 3% as indicated above will not be payable in cases where refund is withheld u/s 245(2) of the ITA.
* **Issue**
	+ While no one can dispute the need for enabling powers to tax authority to withhold refunds to protect revenue interests, there is no provision in the existing ITA or in FB 2023 for a taxpayer to be given an adequate opportunity of being heard before withholding of refunds and/ or their adjustment against existing demands. Taxpayer will be merely given intimation of such action [along with the speaking order under proposed s.245(2), as applicable].
	+ Further, it is seen that on the ground, tax officers routinely make various adjustments to the returned income resulting in demands. In this light, the instant amendment will effectively result in withholding of refunds pending assessment/reassessment for one or other AY on perennial basis.
	+ Additionally, it is practically seen that such refunds are adjusted even against demands even where a stay has been granted in terms of CBDT instruction or by the Income Tax Appellate Tribunal (ITAT).
	+ Withholding of refund for open assessment / reassessment proceedings suggest there is going to be an adjustment while practically this may not be true in each & every case. Each year is a separate year and should not affect proceedings for other years. Also, if there are favorable rulings in assessees own case from HC or ITAT for same issue for which adjustment is done by AO year on year basis, then withholding due refund will be unjust to taxpayer as refund will get stuck for very longer duration.
	+ The above causes serious hardship to the taxpayer, wherein blockage of funds results in reducing the ease of doing business and hampers the image of India as a business-friendly destination for attracting foreign investment.
	+ Even harsher is the proposed amendment that if the refund amount is withheld pending assessment/ reassessment and then released post completion of such assessment/ reassessment, the taxpayer will not be entitled to additional interest at 3% p.a. u/s. 244A(1A) which is paid on delay in passing Giving Effect Order beyond 3 months. [In other words, only normal interest u/s 244A(1) of 6% will be payable.]
	+ While taxpayer receives interest on refund at maximum rate of 9% p.a. (including additional interest for the period post 3 months), interest payable by the taxpayer u/s 234B is at 12%p.a which is discriminatory. The proposed amendment only seeks to further widen this differential by proposing to disqualify taxpayer from receiving additional interest for the period when refund is withheld under proposed s.245(2).
	+ Such disparity is inexplicable considering that interest is paid for use of money and is compensatory in nature [as held by the SC in Dr. Pranoy Roy [2009] 179 Taxman 53 (SC)]. Thus, ideally, money, having only a single colour, should invoke the same amount of interest whether it is to be paid to the tax department or receivable therefrom.
	+ Moreover, provision to pay additional interest was introduced with the intention to bring down inordinate delays in processing refunds arising out of OGEs. With the proposed amendment, intent of the section will get defeated.
* **Recommendations**
	+ At the outset, it is recommended that the proposal to allow withholding of refunds against pending proceedings of other years (not being the year in which refund arises) be withdrawn. At the very least, it may be clarified that such refund sought to be withheld is only the refund determined in accordance with intimation issued u/s 143(1) of the ITA.
	+ Separately, the practice of adjusting refunds against stayed demands is also recommended to be discontinued. Additionally, set-off of refunds may also not be carried out in cases where there exist favorable judicial precedents (especially in the taxpayer’s own case for earlier years) in regard to the same issue.
	+ Notwithstanding the above, it is recommended to insert a provision requiring the tax authority to give the taxpayer an adequate opportunity of being heard before taking action of adjustment or withholding of refund. Further, adjustment or withholding of refund must be vide a speaking order only [and not an intimation as u/s 245(1)] which may be made appealable before CIT(A).
	+ It is also recommended that the provisions of grant of interest on refunds be brought at par with interest payable by taxpayer on taxes payable to revenue authorities. Alternatively, the refund withheld should be treated as regular payment of tax to reduce interest u/s. 234B @ 12% p.a. for the period from date of withholding till date of completion of assessment/reassessment.
	+ At the very least, there seems to be no warrant for the Government in not paying interest for the period when refund is withheld pending completion of assessment/reassessment. Accordingly, the proposed proviso to s.244A(1A) denying additional interest @ 3% p.a. should be omitted.
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|  | **Roll back expansion of prosecution provisions to TDS defaults on payments in kind [S. 276B]** | * **Existing provision**
	+ The ITA, inter alia, has the following provisions where a payer is required to deduct taxes at source:
1. TDS is applicable at the rates in force in respect of any payment being made by way of winnings from any lottery or crossword puzzle or card game and other game of any sort of an amount exceeding Rs. 10,000 (section 194B).
2. TDS is applicable @10% of the benefit or perquisite in cash/kind or partly in cash/kind arising from business/profession (section 194R).
3. TDS is applicable @1% of the consideration for transfer of a Virtual Digital Asset paid partly in cash/kind or wholly in kind (section 194S).
	* In this respect, it is specifically provided that the payer is required to withholding tax or otherwise ensure payment of tax as above even in cases where payment of the above nature is made in cash/ kind or partly in cash/ partly in kind.
	* For this purpose, Para 51.2 of Circular No. 763 dated 18 Feb 1998 clarifies that **ensuring payment of tax** in respect of winnings in kind may be made, as one example, by the payer recovering cash equivalent of taxes from the winner and paying to Government.

Similarly, FAQ 9 of CBDT Circular No. 12/2022 dated 16 June 2022 in the context of TDS under section 194R provided for various alternatives for **ensuring** **payment of tax**, such as; (i) Requiring the payee to make advance tax payment equivalent of TDS amount and providing copy of such challan with declaration to the payer, (ii) Deduction of tax by payer and payment to Government after reckoning that such tax paid by him as TDS is also a benefit u/s. 194R (i.e. by appropriate grossing up for net of tax payment).* + In this respect, ITA presently has the following provisions to address cases of default in tax withholding:
1. Provisions of section 271C provide for levy of penalty equal to the amount of tax not deducted in case where the taxpayer fails to deduct the whole or part of the tax. Additionally, penalty is also leviable in respect of failure to pay taxes in respect of winnings payable wholly or partly in kind.
2. Provisions of section 276B provide for prosecution with fine & imprisonment for a term of 3 months extendible to seven years where the taxpayer fails to pay the tax deducted. Additionally, prosecution also triggers in respect of failure to pay taxes in respect of winnings payable wholly or partly in kind.
	* As evident from the above, barring cases of winnings covered by S. 194B, at present, prior to proposed amendment by FB 2023, the prosecution provision of section 276B does not cover cases where there is failure to deduct tax under the provisions of section 194B/194R/194S. This is consistent with the distinction between failure to deduct tax and failure to pay tax which is already deducted. The former is liable to penalty alone whereas latter is liable to both penalty and prosecution.
* **Proposed amendment**
	+ Finance Bill 2023 proposes to expand the scope of prosecution under section 276B to also cover cases of default in not deducting tax on in-kind payments under section 194R, section 194S, and the proposed section 194BA in addition to section 194B as was previously provided.
* **Issue**
	+ So far, barring cases of winnings, the tax policy has been that failure to deduct tax will attract penalty but not prosecution. Prosecution is attracted only if there is failure to pay taxes which are already deducted/collected – since such monies are held as agent for the Government. This policy will continue for payments in money but failure to deduct tax on payments in kind will henceforth attract prosecution in addition to penalty.
	+ S. 194R and S. 194S are as yet relatively nascent provisions while S. 194BA is only proposed to be introduced vide FB 2023. The provisions have implementation and interpretational challenges (for instance, u/s 194R issues persist around what is to be considered as benefits or perquisites, what is value of benefit in-kind, etc.) till date. Widening prosecution provisions for non-compliance (failure to deduct tax on payment in kind) are draconian and defeats larger objective.
	+ Though Govt has tried to clarify quite a few issues but still there are practical challenges which needs clarity. Govt should allow some time for taxpayers to settle down on compliances before prosecution provisions are introduced.
	+ There could be various controversial issues on TDS on payments in kind on whether a particular item constitutes benefit or perquisite, what should be its value, etc. Criminalizing such defaults is not a sound tax policy measure. It will merely lead to increase in litigation and adversely impact ease of doing business.
	+ In other laws, the Government is decriminalizing certain administrative defaults. Even in income tax, it is proposed by Finance Bill 2023 to decriminalize certain administrative tax compliances by liquidator of company. However, the proposal to criminalize TDS default for payments in kind is a step in reverse direction of decriminalization.
* **Recommendations**
	+ It is strongly recommended that proposed expansion of prosecution provisions for mere default of non-deduction of tax on in-kind payments should be dropped. Prosecution should be applicable only in cases where tax is deducted but not paid to the Government. For instance, where provider of benefit in kind collects tax from the payee but does not pay to the Government, the provider can be prosecuted even under existing provisions.
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|  | **Relax applicability of electronic submission of Form 10F to non-resident payees not having a PAN** | * **Existing Provision and Issue**
	+ In order to claim treaty benefit, section 90(4) of the Act requires Non-resident payees (NR payee) to obtain Tax Residency Certificate (TRC) from its country of residence (COR). Further, section 90(5) of the Act requires NR payee to further furnish certain information in Form 10F, if the details as required under Rule 21AB of the Income-tax Rules, 1962 (Rules) is not available in TRC issued by COR of NR taxpayer.
	+ Till 16 July 2022, general practice adopted was to execute Form 10F manually. CBDT vide notification No. 3/2002 dated 16 July 2022 (the Notification) has mandated NR payees to file certain forms electronically. The list also included Form 10F as required to be furnished under section 90(5) of the Act read with Rule 21AB of the Rules. The Notification was applicable with immediate effect.
	+ For the purpose of e-filing of Form 10F, the NR payee would be required to log in to their income-tax e-filing website. Such login is permissible only if NR payee has obtained PAN in India. Accordingly, NRs who are not mandated under any other provision to get a PAN, are now required to obtain one so that they can login to e-filing website of income-tax and generate Form 10F.
	+ In order to remove such procedural difficulty, CBDT issued a notification (notification no. 2 of 2022) dated 12 December 2022 wherein NRs not having PAN and not required to have a PAN as per relevant provisions of the Act were exempted from mandatory electronic filing of Form 10F till 31 March 2023 and could continue to make statutory compliance of filing of Form 10F in manual form.
* **Recommendation**
	+ To remove procedural difficulties in case of NRs not required to have a PAN, it is recommended to exclude such NRs from electronic filing of Form 10F and allow such NR taxpayers to continue to execute manual Form 10F without specifying any cut-off date.
	+ Alternatively, it is recommended that a separate gateway can be created on e-filing website so that NRs not required to mandatorily obtain a PAN can login to e-filing website only to generate Form 10F. Also, the requirement to sign Form 10F with a DSC should be relaxed for such NRs.
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|  | **Exemption from obtaining Permanent Account Number from non-residents to open bank account with IBUs in IFSC** | * **Issues**
	+ Earlier, non-corporate non-residents were allowed to open account with IFSC banking unit (IBU) in the International Financial Services Centre (IFSC) on the basis of Form no. 60 as such non- residents generally did not have taxable income in India exceeding the basic exemption threshold. Accordingly, they were not required to apply for a PAN in India. Also, such non-residents are not liable to obtain Aadhaar in India. Further, PAN is also mandatory even in case of corporate non-residents which do not have income chargeable to tax in India.
	+ A non-resident can open a Fixed Deposit account or have any other banking relationship with an IBU branch such as a current account, loan account, counterparty for derivative contracts etc. Post insertion of rule 114BA and rule 114BB in the Income Tax Rules, 1962 (‘the Rules’), such non-residents are unable to undertake the specified transactions in absence of PAN. For all such customers, it is not practical to obtain a PAN. The requirement to quote PAN has led to genuine hardship for them as exclusion is only provided to Central Government, State Government, and consular offices under rule 114BB of the Rules.
	+ There shall be instances where the total income earned by such non-residents transacting through the IBUs shall be exempt under section 10 or section 47 of the Act.
	+ However, as mentioned above, the Indian income-tax law requires non-residents to obtain a tax registration (i.e., obtain PAN). The need to obtain tax registration requires a non-resident to go through the rigour of compliances in India. While this approach may be required for the non-residents transacting with banks in the domestic market, an IFSC regime should be more friendly in terms of compliance requirements.
* **Recommendation**
	+ To remove the genuine hardship faced by non-residents opening account in IFSC, exemption should be provided to them from rule 114BA, 114B and 114BB of the Rules. Alternatively, a Tax residency certificate (TRC)/ Tax identification number (TIN) can be made mandatory for opening account in IFSC.
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| **Business Trusts** |  |
|  | **Provide for pass through taxation in respect of income earned by business trust on accrual basis [S. 56(2)(xii)]** | * **Existing Provision**
	+ As per industry practice, business trust holds equity shares as well as debt instrument issued by SPV. Traditionally, business trust earns following nature of cash flow having tax impact as under:
		1. **Interest income earned by business trust from SPV** – exempt in the hands of business trust under section 10(23FC)(a) of ITA but taxable in the hands of unit holders under section 115UA(3)
		2. **Dividend income earned by business trust from SPV** – exempt in the hands of business trust under section 10(23FC)(b) of ITA but taxable in the hands of unit holders under section 115UA(3) if SPV has exercised the option under section 115BAA of ITA
		3. **Rental income earned by REIT** – exempt in the hands of REIT under section 10(23FCA) of ITA but taxable in the hands of unit holders under section 115UA(3)
		4. **Capital gains and treasury income earned by business trust** – taxable at maximum marginal rate in the hands of business trust and exempt in the hands of unit holders under section 10(23FD) of ITA
		5. **Repayment of debt by SPV to business trust** – Essentially, debt granted by business trust to SPV is repaid by SPV as and when the business of SPV grows. Repayment of debt by SPV is nothing but receipt of debt capital given by business trust SPV. Receipt of debt capital granted by business trust cannot be income considering the general principles of ITA.

Where sum paid by business trust to unit holders bear the character of the repayment of capital, there is effectively return of capital from the perspective of unit holders and is not income of unit holder.From the above, it is clear that income earned by business trust from all sources is either taxed in the hands of business trust or unit holders. Business trust and unit holders are effectively alternative taxpayers.* **Proposed Amendment**
	+ FB 2023 proposes to insert section 56(2)(xii) to provide that any sum received by unit holders from a business trust which is not in the nature of
		1. Interest income from SPV
		2. Dividend income from SPV
		3. Income chargeable to tax in the hands of business trust in terms of section 115UA(2) shall be income of unit holder. Further, amendment is proposed in section 2(24) of ITA to cover sum referred in section 56(2)(xii) within the definition of ‘income’.
	+ Para 5 under the head *‘Tax avoidance through distribution by business trusts to its unit holders’* of Explanatory Memorandum (at page 25) provides categories of sum received by unit holders from business trust. One of the categories is ‘Repayment of Debt’. Para 6 of EM provides that category of repayment of debt by business trust to unit holder is actually an income of unit holder which does not suffer taxation in the hands of business or unit holders. Para 7 of EM provides that dual non-taxation of such repayment of debt is not the intent of special taxation regime provided for unit holders.

In the above background, EM provides that to avoid dual non-taxation, provisions of section 56(2)(xii) are sought to be inserted. * **Issue**
	+ From the EM, it is discernible that Revenue shall be in a position to collect the tax on the income earned by business trust either from the business trust or unit holders. The intent of the Legislature does not seem to tax the amount which does not have the character of income.
	+ From the EM, it seems that Revenue does not intend to tax item which is not income in nature but wishes to bring all receipts to tax. Considering the wide coverage of section 56(2)(xii), even where sum received by unit holder from business trust which is not in the nature of income may also get covered within the scope of taxation.
* **Recommendation**
	+ Considering that section 56(2)(xii) is sought to be introduced for preventing tax avoidance (as suggested in EM) in order to strike balance between Revenue getting its fair share of tax and taxpayers are not taxed on non-income receipt, following measures are recommended:
	+ Presently, section 115UA of ITA taxes income in the hands of unit holders on distribution basis. In other words, as and when unit holders receive distribution from business trust, same is taxed in the hands of unit holders. Absent distribution, there is no taxation in the hands of unit holders.
	+ Section 115UA of ITA may suitably amended to tax the income on pass through basis in the hands of unit holders on accrual basis and without any deferral[[5]](#footnote-6). Such scheme is comparable to one prevailing for Investment Fund contained in section 115UA of ITA.
	+ In case where no distribution has taken place, a provision similar to section 115UB(6) can be inserted in section 115UA to provide that income not paid or credited at the end of the year shall be deemed to be credited.

Further, an Explanation similar to Explanation 2 to section 115UB may be added to provide that income which is included in total income of unit holder on account of deemed distribution, same shall not be again taxed when business trust distributes such income to unit holders. * + In the above approach, income is taxed in the hands of unit holders without deferral and Revenue would get its share of tax immediately without leakage. Further, section 194LBA dealing with withholding on income distributed or deemed distributed are already present and will allow Revenue to collect information about the unit holders to whom distribution is made.
	+ Additionally, it may be provided that each distribution by business trust to unit holders in the nature of debt repayment by SPV to business trust shall be reduced from the cost of acquisition of units of business trust and appropriate amendment may be made in capital gains chapter.

It may also be provided that as and when the capital repayment exceeds the cost of acquisition of units, there is deemed transfer and entire amount exceeding the cost shall be subjected to capital gains tax without any further deduction[[6]](#footnote-7). * + Section 115UA read with Rule 12CA may be appropriately amended to make changes in Form No. 64A and 64B to track capital repayment by inserting requirement on business trust to furnish information to Revenue Department.
	+ Additionally, a specific provision may be inserted to provide that no withholding shall be carried on sum distributed by business trust to unit holders which is of the nature debt repayment by SPV to business trust.
 |
|  | **Treat redemption of units of business trust as capital gains [S. 56(2)(xii)]** | * **Existing Provision**
	+ On redemption, units held by unit holders are cancelled and in lieu of cancellation sum is paid by business trust to unit holders.
	+ Units of business trust are capital assets. It is well settled that the event of redemption of unit is not a tax-free event. On redemption of units, there is ‘extinguishment’ of units and hence ‘transfer of capital asset’ and covered by capital gains chapter.
* **Proposed Amendment and Issue**
	+ Considering the wide language in parenthesis of section 56(2)(xii) – *‘any sum received by unit holder from a business trust’*, amount received by unit holder on redemption can be covered by section 56(2)(xii).
* **Recommendation**
	+ It is recommended that suitable amendment in language of section 56(2)(xii) or proviso should be inserted to section 56(2)(xii) to provide that income from redemption of unit shall be governed by capital gains chapter and not covered by section 56(2)(xii). Further, such distributions should be charged to tax in the hands of unitholders only when the distributions exceed the cost of acquisition of such units.
	+ Additionally, it is also recommended that an amendment shall be carried out to provide that no withholding shall be carried out at the time of sum paid on redemption as such leads to an onerous obligation on business trust to determine the taxability of each unit holder which is practically difficult if not impossible.
 |
|  | **Provide for tax free pass through of exempt income earned by business trust and distributed to unit holders [S. 56(2)(xii)]** | * **Existing Provision**
	+ In terms of SEBI (Investment Infrastructure Trust) Regulations, 2014 and SEBI (Real Estate Investment Trust) Regulations, 2014, business trust are permitted to park their funds in listed or unlisted debt, equity shares of listed companies, Government Securities, Money Market Mutual Fund etc.
	+ There are cases where business trusts have parked their funds in tax free Government Securities or tax-free bonds issued by Government companies[[7]](#footnote-8) and income from such securities is exempt under section 10 of ITA.
	+ Exempt interest income earned by business trust does not enter computation provision on account of language employed in parenthesis of section 10[[8]](#footnote-9). Consequently, exempt income earned by business trust is not chargeable to tax under section 115UA(2) of ITA.
* **Proposed Amendment and Issue**
	+ Section 56(2)(xii) *inter alia* provides that any sum received by unit holders from business trust and not chargeable under section 115UA(2) of ITA will become income in the hands of unit holders. Exempt income does not enter computation of income / does not form part of total income of business trust and hence not chargeable under section 115UA(2). If such exempt income is distributed by business trust to unit holders, same will be subjected to tax in the hands of unit holders
* **Recommendation**
	+ The mechanism of partial pass through provided in section 115UA (to tax income once either in the hands of business trust or unit holders) and intent of insertion of section 56(2)(xii) do not seek to tax income which is otherwise exempt under general provisions of ITA.
	+ Without prejudice to the recommendations made in above paras, section 56(2)(xii) may contain a carve out for exempt income [other than section 10(23FC)] of business trust distributed to unit holders.
 |
|  | **Protect exemption of investments made by eligible sovereign wealth funds/pension funds u/s. section 10(23FE) of ITA** | * **Existing Provision**
	+ Finance Act, 2020 *inter alia* granted exemption to Sovereign Wealth Fund (SWF) and Pension Fund (PF) under section 10(23FE) of ITA in respect of dividend, interest and long-term capital gains arising from investment made by it in India in units of Investment Infrastructure Trust covered by section 2(13A)(i) of ITA. There is no exemption to any other income earned by such qualifying investors from units in InvIT.
	+ Memorandum to Finance Bill, 2020 bears out that exemption was introduced for promoting investment of SWF / PF / ADIA into India. Budget Speech to Finance Bill, 2020 also bears out that exemption is granted to SWF / PF in order to incentivize investment in priority sector.
* **Proposed Amendment and Issue**
	+ On account of insertion of provision of section 56(2)(xii) of ITA, any sum received[[9]](#footnote-10) by unitholders including SWF / PF will be subjected to tax.
	+ Insertion of section 56(2)(xii) of ITA will adversely impact SWF / PF as these qualifying foreign entities will not be eligible for exemption under section 10(23FE) of ITA in respect of income covered by section 56(2)(xii) of ITA. This is because, as stated earlier, the exemption u/s. 10(23FE) is restricted to dividend, interest and LTCG incomes from units in InvITs. This may adversely impact their investment return computed at the time of making investment and may jeopardize future investment in the priority sectors.
* **Recommendation**
	+ Without prejudice to recommendations in above paras, a specific sub-clause may be inserted in section 10(23FE) of ITA to exempt the income covered by section 56(2)(xii) in the hands of qualifying foreign investor.
 |
| **Charity** |  |
|  | **Roll back partial denial of exemption of donation to other trusts** | * **Existing provision**
	+ Donation from one charitable trust out of income of trust to another charitable trust (other than corpus donation) qualifies as application of income completely.
* **Proposed amendment**
	+ FB 2023 proposes amendment by which donation to other eligible trust qualifies as application only to the extent of 85% of the donation given.
	+ The Memorandum states that such amendment is introduced to curb instances where certain trusts are trying to defeat the intention of the legislature by forming multiple trusts and accumulating 15% at each layer.
* **Issue**
	+ The proposed amendment will adversely hit genuine cases of trusts which pursue its activities in remote area where it has no reach, through grassroot charities active in such remote areas.
	+ In the hands of Donor Trust, despite actual spending by way of donation of 100, only 85% will qualify as application. This will create shortfall in application by Rs. 15% which donor trust will have to make efforts to spend further amount of charitable purpose to meet with threshold of 85%.
	+ Unfortunately, on the grounds of misuse by a few, this proposal will seriously affect the operations of the genuine trusts, who will face the extreme hardship in ascertaining the application because they will not be able to fill the gap of 15% of the donations given to other trusts as these trusts distribute 100% donations to the other trusts engaged in ground level charitable activities.
	+ The same may result in anomaly in as much as though sum / money shall actually flow out of the pocket of the donor trust, but application shall be allowed to the extent of 85% thereof. This may lead to a situation where trust may not have actual funds for future application. E.g., Trust A, out of current income of Rs. 100, donates Rs. 100 to Trust B, which applies entire amount for charitable purpose. In the hands of Trust A, only Rs. 85 shall be allowed as application, whereas the Trust A shall not have actual residual funds of Rs. 15.
	+ Further, for the said 15% not being considered as application of income, the donor trust may have the additional burden of quarterly Advance Tax payments and related compliances.
	+ Further, it would adversely impact trust’s ability to accumulate funds for future events/contingencies
	+ Moreover, this will defeat the very purpose for which the Income-Tax registrations were granted for tax exemptions to the genuine trusts based on the Objects of the Trusts.
* **Recommendations**
	+ In the larger interest of charity community, the proposed amendment may be rolled back.
	+ Alternatively, to continue with 100% tax exemption for genuine trust, it should be clarified that donations given by one trust to another trust will be eligible for 100% deduction if another trust is utilizing donations by expending it for charitable purposes instead of further passing it as donation to another layer of trust. A declaration in this regard can be obtained by donating trust from the other recipient trust.
 |
|  | **Roll back or extend period for depositing back of corpus and repayment of loans or borrowings within 5 years** | * **Existing provision**
	+ Till 1 April 2021, amount applied for charity from loans or borrowing was an eligible application. There was an issue whether when loan or borrowing is repaid from income of the charity, it can qualify as application once again. This could have resulted in duplicated relief i.e., in the year of raising of loan and in the year of repayment of loan.
	+ Likewise, amount spent from corpus funds of the charity was eligible as application. Like in case of loans, corpus was considered as source of funds for spending. However, there was an issue as to on one hand corpus donation is exempt from application rule and on the other hand, charity claims spending out of such corpus donation as application. This was perceived as charity availing dual benefits.
	+ By way of amendment to s. 11(1) with effect from 1 April 2021 (AY 2022-23), application of funds from loan or corpus is not to be reckoned as qualifying application in the year of spending out of these funds but will qualify as eligible application only upon repayment of actual loan or upon restoration of corpus by investment/reposting back from income of given previous year.
	+ However, there was no timeline applicable within which loan repayment or corpus restoration is to be made to qualify as application.
* **Proposed amendment**
	+ Explanatory Memorandum to FB 2023 observes that indefinite time available for repayment of loan/restoration of corpus made implementation of provisions difficult.
	+ Accordingly, it is proposed that loan repayment/corpus restoration from out of income of charity will qualify application only if the same is made within 5 years of spending from the corpus or loan.
* **Issue**
	+ **Amendment providing for period of 5 years:**
		1. Proposal has raised multiple issues of concern to the charities. Firstly, there is no need to place restriction on period. Trust which may not have ability to repay loan or restore corpus within specified period may lose benefit of application permanently. This may result in double whammy. Trust would neither get benefit of application at the stage of spending out of corpus or loan nor at the stage of repayment or restoration. Surely such cannot be legislative intent as well.
		2. For instance, consider a case where trust borrows money -say, to deal with some calamity as part of its objects, may not be able to build up income to repay loans in short period of 5 years. Despite spending being on objects of the trust and for bona fide purposes, trust would lose the benefit of application. There could be many such scenario where repayment of loans or restoration of corpus within 5 years period may be practically difficult. It is not a case of misuse of provision.
		3. Also, it is not clear which sort of implementation difficulty the Explanatory Memorandum envisages. It may be good to work around resolving such difficulty, if any, rather than capping time limit on the taxpayer’s bona fide activities. As one alternative, necessary detail or information may be captured in ITR form about spending so that same can be retrieved in future to verify the claim of the taxpayer, if so required. Digital mode makes it easy to retrieve information for any period. Still alternatively, taxpayer may be asked to maintain and furnish certain specified evidence - say, auditor’s certificate in support of claim for valid application in the year of repayment of loan or restoration of corpus.
		4. Still, if there are serious concerns on implementation of new regime provisions as suggested in Explanatory Memorandum, Government may consider restoring the pre 2021 law and grant benefit of application to trust in the year of spending on charitable objects from out of loan or corpus and deny the same when loan is repaid, or corpus is restored. This can also solve apprehension of double deduction.
		5. Without prejudice, period of 5 years is too low. There are many scenarios where ITA itself provide longer period for claims which have so far did not pose any challenge in its implementation. For instance, for set off of claims for losses in case of Start-ups, 10 years period or in other cases, 8 years is provided. In the midst of such realities, there is no warrant to discriminate with charitable institutions which do noble cause, with shorter period of 5 year.
	+ **Amendment prescribing 5 years period has retroactive effect:**
		1. Without prejudice, period of 5 years within which corpus restoration or repayment of loan is proposed for application is likely to have retroactive application. Language provides calculation of period from year of application of corpus or loans or borrowings and may turn time barred even before enactment of Finance Act 2023.
		2. Suppose loan borrowing was utilized on objects of the trust in – say, 2017-18 but no application was than claimed. If loan is repaid even in year 2024, taxpayer may not qualify for application as claim turns time barred on 31 March 2023 viz before implementation of provisions of Finance Act 2023.
		3. It is fit case for making application of the proposed provision prospectively to reckon period of 5 years for any spending out of loan or corpus made on or after 1 April 2023.
* **Recommendations**
	+ The proposed amendment placing cap of 5 years may be rolled back completely.
	+ Alternatively, pre 2021 law may be restored to grant benefit of application at the stage of spending on charitable purposes out of corpus or loans or borrowings and deny benefit on repayment of loan or restoration of corpus.
	+ Without prejudice, period of 5 years is too short and may be elongated to at least 10 years.
	+ Still, without prejudice, proposed amendment may be made prospective to reckon period of 5 years for any spending out of loan or corpus made on or after 1 April 2023.
 |
|  | **Roll back trigger of exit tax provisions on failure to apply for registration / re-registration** | * **Existing provision**
	+ Section 115TD concerning exit tax levy is presently triggered, amongst others, in cases where charitable institutions are converted into any form which is not eligible for registration under Section 12AA/12AB or Section 10(23C).
	+ The expression ‘converted into any form which is not eligible for registration under Section 12AA/12AB or Section 10(23C)’ is defined to cover cases where:
		1. The registration granted under Section 12AA / Section 12AB or Section 10(23C) is cancelled.
		2. The charitable institution has adopted or undertaken modification of its objects which do not conform to the conditions of registration, and it (i) has not applied for fresh registration under Section 12AA/12AB or Section 10(23C), or (ii) has filed for fresh registration and the application is rejected.
	+ Once Exit tax provisions trigger, charitable institution is liable to levy of income tax at maximum marginal rate on accreted income being difference between aggregate fair market value of the total assets of the trust or institution over the total liability as on the specified date and in accordance with prescribed valuation method.
	+ Additionally, on trigger of exist tax, the principal officer / trustees of charitable institutions are liable to pay the exit tax within prescribed period of 14 days from the specified date as applicable.
* **Proposed Amendment**
	+ FB 2023 proposes to extend exit tax provision to charitable institutions which fail to make an application for registration or renewal in accordance and within the period specified in the provisions of Section 12A(1)(ac)(i)/(ii)/(iii).[[10]](#footnote-11) In such case, defaulting charitable institution is deemed to have ‘converted into any form which is not eligible for registration under Section 12AA/12AB or Section 10(23C)’.
* **Issue**
	+ The exit tax provisions are presently triggered only in the certain specified events, involving case of conversion, in any form not eligible for registration under exemption under ITA. This includes certain cases of serious defaults by charitable institutions where registration itself can be cancelled. For instance, trust’s income is applied otherwise than on objects of the trust or which does not enure for benefit of public or, activity of the trust is not genuine or not carried out in accordance with conditions of registration or there is material breach of applicable provisions of other laws.
	+ While there can be no complaint on applicability if Exit tax levy for cases involving serious defaults which involve conversion into non charitable form, it is reasonable to distinguish cases of default in registration and its renewal.
	+ The registration procedure for charitable trusts has been revamped in 2021, under which existing registered trusts were required to obtain fresh registration under new regime. New registration procedure also mandates periodic renewal (within 3 or 5 years) of their registration. Trusts to make application in Form 10A / 10AB together with host of details and evidences. Further, any renewal application is to be filed by and large within period of 6 months before the date of expiry of existing registration and due date so prescribed is much ahead of expiry of earlier exemption period which is prone to be missed out. Owing to the complex changes, there may be instances that certain old charities may have genuinely missed on complying with the renewed registration procedure within the timelines of the applicable provisions. In such cases, there may be an unintended lapse by the charitable trusts in obtaining registration/renewal. Presently, there is no guidance on filing of belated application and scope of seeking condonation of delay.
	+ Further, there may be instances where charitable trust may prefer to carry out charitable objects, while choosing to be unregistered under the ITL provisions and pay taxes on its annual income. This may be owing to the complexities and compliances necessitated otherwise. In such cases too, they may not be operating for other than charitable purpose, but in view of the proposed amendment may be subjected to exit tax. Also, there may be double whammy as exit tax provisions will apply even if in earlier years income may have borne tax. Present s. 115TD(2) does not provide any exception covering such contingency in computing accredited income.
	+ There will be great hardship to cases involving venial breach or non-compliance in the matter of registration or its renewal if they are also covered by rigor of exit tax. Hypothetically, as per proposed amendment even a single day delay in registration or renewal may trigger exit tax. Any such watertight requirement with harsh consequences of exit tax is completely disproportionate to degree of default. Impact may be highly exponential for old trusts where assets value has increased multi-fold.
* **Recommendations**
	+ It is recommended that the proposal may be rolled back.
	+ Without prejudice, an appropriate procedure may be prescribed for condonation of delay in registration/renewal by way of an opportunity to charitable institutions to set right default before trigger of exit tax.
	+ Still, without prejudice, instead of levy of exit tax in cases of venial breach or non-compliance, a penalty may be prescribed if taxpayer is not able to prove reasonable cause.
	+ Without prejudice, suitable back up amendment is required to provide for cost step up for assets which suffer exit tax at fair value to avoid any double taxation risk when trust sells such asset in future.
	+ Suitable exclusion may be provided in definition of ‘accreted income’ for accreted income represented or attributable to tax paid income.
 |
|  | **Resolve ambiguity in second proviso to Explanation 4 dealing with pre 2021 application** | * **Existing Provision:**
	+ Finance Act 2021 inserted Explanation 4 to s. 11(1) of ITA with two clauses (i) and (ii). Clause (i) provides that with effect from 1 April 2021 application of funds from corpus is not to be reckoned as qualifying application in the year of spending out of these funds. Proviso thereto, however, provides a facility to claim benefit of application upon restoration of corpus by investment/reposting back from income of given previous year.
	+ Similarly, clause (ii) provides with effect from 1 April 2021 application of funds from loan or borrowing is not to be reckoned as qualifying application in the year of spending out of these funds. Proviso thereto, however, provides a facility to claim benefit of application upon repayment of loan from income of given previous year.
	+ Both provisos granting benefit of application apply in a case where amount of part thereof was “not so treated as application” in the year of spending from corpus or loan or borrowing. Thus, qualification to claim application in the year of repayment or restoration is that the trust should have not claimed benefit of application in the year of spending out of loan or borrowing or corpus. This is obvious and is with a view to avoid case of duplicated benefit.
* **Proposed Amendment:**
	+ **The amendment proposes to insert Fourth proviso respectively to clause (i) and Clause (ii) to Explanation 4 to s. 11(1) which reads as under:**

**“***Provided also that nothing contained in the first proviso shall apply where application from the corpus is made on or before the 31st day of March, 2021***”****“***Provided also that nothing contained in the first proviso shall apply where application from any loan or borrowing is made on or before the 31st day of March, 2021***”*** + **Explanatory Memorandum clarifies as under:**

**“***2.2 While implementing the recent changes vide the Finance Act, 2021 to the provisions related to corpus and loan or borrowing, it has come to the notice that application from corpus or loan or borrowings have already been claimed as application prior to 01.04.2021. Hence, allowing such amount to be application again as investment or reposting back in corpus or repayment of loan or borrowing will amount to double deduction.**2.5 In order to ensure proper implementation of both the exemption regimes, it is proposed to provide that application out of corpus or loans or borrowings before 01.04.2021 should not be allowed as application for charitable or religious purposes when such amount is deposited back or invested in to corpus or when the loan or borrowing is repaid. It is further proposed to provide that if the trust or institution invests or deposits back the amount in to corpus or repays the loan within 5 years of application from the corpus or loan, then such investment/depositing back in to corpus or repayment of loan will be allowed as application for charitable or religious purposes. It is also proposed to provide that where the application from corpus or loan did not satisfy the conditions as stated in paragraph 2.4, the repayment of loan or investment/depositing back in to corpus of such amount will not be treated as application.***”*** **Issues:**
	+ Intent of proposal appears to clarify that any spending from corpus or loan or borrowing made prior to 1 April 2021 and is claimed as application of income in that year, such taxpayer is not entitled benefit of application again when it repays loan or restores corpus. Accordingly, applicability of proviso to Explanation 4 is proposed to be denied in such case. However, proviso to Explanation 4 itself grants benefit of application only if it was earlier ‘not so treated as application’. And, now omitting application of proviso completely for spending done prior to 1 April 2021, trust will be completely denied benefit of application in the year of repayment of loan or restoration of corpus even where trust as a matter of fact, had not claimed benefit of application in the year of spending.
	+ Secondly, language of proposed proviso is ambiguous and prone to give rise to litigation. It denies applicability of first proviso where application from any loan or borrowing or corpus is made on or before the 31st day of March 2021. Reference to application is prone to an interpretation that loan or corpus funds are applied /utilized on or before 31 March 2021. This may be read erroneously by AO deny benefit to very corpus or loan funds utilized prior to 1 April 2021 even where trust had not claimed benefit of application thereof in that year. This is contrary to intent expressed in Explanatory Memorandum.
* **Recommendations:**
	+ Proposal to insert Fourth proviso in clauses (i) and (ii) to Explanation 4 to s. 11(1) may be rolled back.
	+ Alternatively, it may be clearly brought out that proposed Fourth proviso will apply to cases where benefit of application under s. 11 was claimed on or before 31 March 2021.
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1. Source: AUC – FPI (September 2022) - NSDL [↑](#footnote-ref-2)
2. Source: EY Research [↑](#footnote-ref-3)
3. Limits have been revised and criteria for classification also includes turnover of the enterprise (refer Notification No. F. No. 2/1(5)/2019 dated 1 June 2020 issued by the Ministry of Micro, Small and Medium Enterprises [↑](#footnote-ref-4)
4. Such non-qualified assets include immovable property not used for business, loans and advances (other than in money-lending business), shares & securities, jewellery (except stock-in-trade), etc. [↑](#footnote-ref-5)
5. It may be noted that section 115U (dealing with taxation in the hands of Venture Capital Fund and its unit holders) as inserted by Finance Act, 2001 operated on distribution taxation in the hands of unit holders. Vide Finance Act, 2012 (w.e.f. 1 April 2013), taxability from distribution-based model was amended to accrual-based model. Similar approach can be adopted. [↑](#footnote-ref-6)
6. In this regard, reference is made to section 45(1B) read with Rule 8AD dealing with taxation in case of ULIP. Section 45(1B) triggers capital gains taxation in the year of receipt of any amount under ULIP. It provides that the profits and gains arising from such receipt shall be liable to tax as ‘Capital Gains’. It gives authority to CBDT to prescribe the manner of calculation of taxable income. Rule 8AD(1) prescribes that in the year of receipt of any amount under ULIP, the premiums paid till the date of receipt is allocated as cost thereof and allowed as deduction. Accordingly, it follows principle of capital recoupment / pay back method. Such approach can also be adopted for capital repayment. [↑](#footnote-ref-7)
7. Bonds issued by NHAI, NABARD, PFC, IIFCL, HUDCO [↑](#footnote-ref-8)
8. *In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included -* [↑](#footnote-ref-9)
9. Other than sum which is of the nature (a) interest income from SPV (b) dividend income from SPV and (c) income which is taxable in the hands of business trust under section 115BAA [↑](#footnote-ref-10)
10. Also clause (i),(ii),(iii) of first proviso to Section 10(23C) [↑](#footnote-ref-11)