

# Tax Hotline

July 24, 2024

## UNION BUDGET 2024: PAVING THE WAY FOR DEVELOPED INDIA

The Finance Minister, Ms. Nirmala Sitharaman (FM) presented the Union Budget (“**Budget**”) for financial year (“**FY**”) 2024-25 on July 23, 2024. This was the first Budget of the newly elected Government. Compared to the last two terms, there was an increased sense of excitement and anticipation about what this year's Budget would entail in this epoch of a coalition government and a stronger opposition, particularly to see how the Budget seeks to achieve fiscal federalism.

As was indicated in the Interim Budget announced earlier this year, the Government continues to stay on the path of fiscal consolidation and economic stability. In this regard, it has estimated the fiscal deficit for FY 2024-25 to be 4.9% of the GDP with the aim to further reduce it to less than 4.5% by next year.<sup>1</sup> The outlay for capital expenditure being increased by only 11.1% (as was also expressed in the Interim Budget) as opposed 35-37% in the last few years, further buttresses the Governments’ resolve to achieve fiscal consolidation.

While being committed in its resolve for fiscal consolidation to prevent unchecked inflation, the Budget seeks to retain the current steady growth of the economy by giving impetus to private spending by rationalizing personal income-tax rates, ensuring social welfare and inclusive development, inspiring investor confidence by keeping fiscal deficit targets under check, adopting measures for ease of doing business etc.

Staying committed to its vision of achieving Viksit Bharat (Developed India) by 2047 and doing so in an inclusive manner,<sup>2</sup> the Budget envisages 9 ‘priorities’<sup>3</sup> which it wishes to focus on in the coming years. Some of the key priorities are discussed below.

The Government wishes to increase *productivity and resilience in Agriculture* by transforming agricultural research, releasing new high yielding and climate resilient varieties of horticulture crops and implementation of a Digital Public Infrastructure (DPI) for maintaining the records of farmers and their lands.

Given the staggering rate of unemployment in India, one of the most crucial aspects of this Budget is its focus on *employment and skilling*. The Budget has announced the introduction of several schemes for Employment Linked Incentive (ELI) based on enrolment in the employees’ provident fund organization (EPFO).<sup>4</sup> The Economic Survey for 2023-24 had set out the importance of skilling in addressing the issue of unemployment. In this context, the Budget’s announcement on introduction of schemes for the skilling of employees is a much needed and a welcome move. The Government also intends to launch a scheme for providing internship opportunities in 500 top companies by providing an internship allowance of INR 5,000 per month for 12 months to 1 crore youth in 5 years.

The Budget brings out the aspect of fiscal federalism in one of its priorities titled *inclusive human resource development and social justice*. Under this priority, the Government intends to formulate a plan for all round development of the eastern region of the country covering Bihar, Jharkhand, West Bengal, Orissa, and Andhra Pradesh. Particularly, it seeks to support development of an industrial node at Gaya on the Amritsar – Kolkata Industrial Corridor to catalyse industrial development of the eastern region. The Budget has also announced the opening of more than 100 branches of the India Post Payment Bank in the North-Eastern region. The Government also seeks to support development of road connectivity projects, power projects, airports, medical colleges etc. in Bihar. With respect to Andhra Pradesh, the Government seeks to provide financial support to Andhra Pradesh for supporting the re-organization of Andhra Pradesh, completing the Polavaram Project (a lifeline for Andhra Pradesh and its farmers), building essential infrastructure such as water, power, railways and roads in Kopparthy node on the Vishakhapatnam- Chennai Industrial Corridor and Ovrakal node on the Hyderabad-Bengaluru Industrial Corridor. It also seeks to provide grants for the backward regions in Andhra Pradesh such as Rayalaseema, Prakasam and North Coastal Andhra. Such steps towards assisting states is a welcome sign towards imbibing the essence of fiscal federalism and it is hoped that similar such steps are taken for other states as well in the years to come.

Recognizing the importance of Micro, Small and Medium Enterprises (“**MSMEs**”) in economic growth and development, the Budget seeks to provide several incentives to MSME’s such as credit guarantee for MSME’s in the Manufacturing Sector, credit support to MSME’s during stress period, enhancement of limit for Mudra loans, providing them with e-commerce hubs for selling of products in the international market etc.

To facilitate ease of doing business in India, the Government seeks to extend the services of the Centre for Processing Accelerated Corporate Exits (C-PACE) for voluntary closure of limited liability partnerships (LLPs) to reduce the closure time, set up an integrated technology platform for improving the outcomes under the Insolvency and Bankruptcy code (IBC), setting up of additional benches of the National Company Law Tribunal (NCLT) for increased resolutions under the IBC, steps for reforming and setting up more benches of the Debt Recovery Tribunal etc..

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Some of the other key announcements include measures for fostering different forms of renewable energy, increase in infrastructure development, tourism, innovation and R&D. The Budget also seeks to set up a venture capital fund of INR 1,000 crore for expanding the space economy, develop taxonomy for climate finance, work on getting legislative approval for creating a flexible model for financing leasing of ships and aircraft, and pooled funds of private equity through a variable company structure. It was also announced in the Budget that rules pertaining to foreign direct investment and overseas investments will be simplified to facilitate foreign direct investments, nudge prioritization, and promote opportunities for using Indian Rupee as a currency for overseas investments. It will be interesting to see what changes are introduced in this regard - will the liberalized remittance scheme (LRS) be further liberalized?, will certain restrictions on investing in financial services overseas be relaxed under the overseas investment laws.

On the direct tax front, the Budget announced a comprehensive review of Income-tax Act, 1961 ("ITA"), to make it more concise, lucid, easy to read and understand. It seeks to do so in 6 months. This was attempted earlier in 2010 through the Direct Taxes Code Bill, 2010, which lapsed and could not become a law. It will be interesting to see the efforts of this Government in overhauling the ITA this time around.

One of the major announcements of the Budget is revision of the slab rates for personal income tax in the new tax regime where essentially 3 new slabs have been created for income above INR 10 lakhs. Additionally, for individuals opting for the new regime, the standard deduction has been increased from INR 50,000 to INR 75,000. Another major announcement is the abolition of Angel tax, i.e. on consideration received by Indian companies for issuance of equity shares at a premium. Given the general sentiment and the resistance of the stakeholders against Angel Tax, including from a constitutional perspective, this is a big move and will be well received. The abolition of the Equilisation Levy (EL) on e-commerce supply of goods and services is another major announcement which has been getting a lot of traction from the stakeholders. This also indicates the Government's resolve to support the Two Pillar Solution.

The Budget has also made certain major announcements with respect to capital gains tax whereby the rate of tax on long-term capital gains ("LTCG") is proposed to be made 12.5% for all types of assets, irrespective of the transferor being a resident or a non-resident. While this simplification of the capital gains regime is a welcome move, and in some cases the rates have decreased, the non-resident investors will suffer from a higher rate of LTCG tax across all types of assets. Even for FPI's, the tax rates for listed securities has been increased from 10% to 12.5%<sup>5</sup> in case of LTCG and 15% to 20% in case of STCG.

Several measures have also been taken to reduce the pendency of direct tax litigation such as simplification and rationalization of provisions pertaining to re-assessments (the major change in this regard being the reduction of the outer limitation period for re-assessments from 10 years to 5 years from the end of the relevant AY), rationalization of provisions related to search and seizure, announcement of Vivad Se Vishwas Scheme, 2024 for settlement of pending tax disputes, provision for withdrawal of applications from the Board for Advance Rulings ("BAR") etc.

On the indirect tax front, expressing the success of the Goods and Services Tax ("GST") regime and with an intention to multiply the benefits of GST, the Government proposes to continue to strive to further simplify and rationalize the tax structures and endeavor to expand it to the remaining sectors. Further, the Budget announcements with respect to revisions on the customs duties seem to be commendable as they seek to achieve the delicate balance of incentivizing local manufacturing whilst at the same time retaining the international competitiveness of domestic products and attractive prices for consumers. Specifically, measures in this regard include full exemption from customs duties for cancer medicines, rationalized reduction in Basic Countervailing Duties (BCD) in sectors which have seen a boom in local manufacturing and exports such as mobile phones, marine products, leather and textiles, precious metals, electronics to enhance their international competitiveness. On the other hand, the Budget seeks to increase the BCD for telecommunication equipment to incentivize domestic manufacturing. It also seeks to increase BCD in case of PVC flex banners, which, being non-biodegradable, are hazardous for the environment and health.

In conclusion, the Budget seems to be a mature Budget which seeks to achieve inclusive growth and development whilst maintaining economic stability. Having said that, some of the reforms which were anticipated but have not been brought about include measures to resolve issues pertaining to overseas listing of Indian companies, Indian tax issues pertaining to reverse flipping etc. Further, while Angel tax has been abolished and much like any other entity in India, the start-ups will also benefit out of it, no other changes have been pronounced with respect to other tax challenges faced by start-ups.

We have provided below a more comprehensive analysis and further insights on the Budget proposals. Hope you enjoy reading it.

Join us for an interactive [Webinar](#) on Wednesday, July 24, 2024 for insights on India's 2024 Budget.

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1. TAX RATES

A. COMPANIES

1. **Reduced Tax Rates for Foreign Companies:** To achieve greater parity, the tax rate for foreign companies will be reduced from 40% to 35% from assessment year ("AY") 2025-26 onwards. The surcharge rates remain unchanged: 2% on total income exceeding INR 1 crore but up to INR 10 crore, and 5% on total income exceeding INR 10 crore.
2. **No Change in Tax Rates for Domestic Companies; No Extension for Section 115BAB:** Domestic companies opting for the concessional tax regimes under Section 115BAA and Section 115BAB will continue to be taxed at 22% and 15%, respectively, with a surcharge of 10% in both cases. The deadline for new companies to commence manufacturing or production under Section 115BAB has not been extended beyond March 31, 2024, as was the case in the previous budget. Consequently, the concessional regime will not apply to new companies starting manufacturing after March 31, 2024.  
  
Domestic companies not availing the concessional tax regimes will be taxed at 30% or 25%, depending on their turnover for the previous year 2021-22. Specifically, a 25% tax rate applies if the turnover is up to INR 400 crores, and a 30% tax rate applies otherwise. The surcharge rates for these companies remain at 7% for total income exceeding INR 1 crore but up to INR 10 crore, and 12% for total income exceeding INR 10 crores.

B. Individuals, HUF, AOP (other than co-operative society), BOI

The ITA provides taxpayers with two tax regime options: the Old Regime - which allows claiming certain deductions and exemptions, and the New Regime - which offers lower tax rates but does not permit most deductions and exemptions. The New Regime was established as the default tax regime previously.

For AY 2024-25, the tax rates specified in Sections 115BAC will remain unchanged. However, the slab rates under the New Regime have been amended for AY 2025-26, which is expected to result in an additional annual tax saving of up to INR 17,500. The revised slab rates are detailed below:

| Old Regime             |          | New Regime<br>(AY 2024-25) |          | New Regime<br>(AY 2025-26) |          |
|------------------------|----------|----------------------------|----------|----------------------------|----------|
| Taxable income         | Tax rate | Taxable income             | Tax rate | Taxable income             | Tax rate |
| Up to INR 2.5 lacs     | Nil      | Up to INR 3 lacs           | Nil      | Up to INR 3 lacs           | Nil      |
| INR 2.5 lacs to 5 lacs | 5%       | INR 3 lacs to 6 lacs       | 5%       | INR 3 lacs to 7 lacs       | 5%       |
| INR 5 lacs to 10 lacs  | 20%      | INR 6 lacs to 9 lacs       | 10%      | INR 7 lacs to 10 lacs      | 10%      |
| Above INR 10 lacs      | 30%      | INR 9 lacs to 12 lacs      | 15%      | INR 10 lacs to 12 lacs     | 15%      |
|                        |          | INR 12 lacs to 15 lacs     | 20%      | INR 12 lacs to 15 lacs     | 20%      |
|                        |          | Above INR 15 lacs          | 30%      | Above INR 15 lacs          | 30%      |

The surcharge rates applicable to different types of taxpayers will stay the same as they were in the previous year. Specifically, surcharge for association of persons ("AOPs") that consist solely of companies as members remains capped at 15%. Similarly, the surcharge on income derived from dividends and capital gains under Sections 111A, 112, and 112A, continues to be capped at 15%.

Under the New Regime, which offers a reduced tax structure for individuals, the surcharge rate remains at 25%, a reduction from the previous rate of 37%.

Total income threshold for availing 100% tax rebate continues to remain unchanged at INR 5 lacs for Old Regime and INR 7 lakhs for the New Regime.

C. Co-operative Societies, Firms, and Local Authorities

For the AY 2025-26, the tax rates and surcharges for co-operative societies, firms, and local authorities remain

unamended. However, it is important to note that similar to Section 115BAB, the time limit for commencing manufacturing to avail the concessional tax regime under Section 115BAE has not been extended. Therefore, co-operative societies commencing manufacturing after April 1, 2024 will not be eligible for this regime.

2. RATIONALIZATION OF CAPITAL GAINS

Taxation of capital gains is dependent on (i) nature of capital gains i.e. whether LTCG or short-term capital gains ("STCG") and (ii) type of asset being transferred.

Nature of capital gains

Determination of nature of capital gain is dependent on the period of holding of the asset. Section 2(42A) of the ITA provides for determination of period of holding depending on the of asset being transferred.

| Type of asset   | Current period of holding |                   |
|---|---------------------------|-------------------|
|   | Short-term                | Long-term         |
| <div><div></div>Listed equity share of an Indian company</div> <div><div></div>Listed debenture</div> <div><div></div>Unit of Unit Trust of India</div> <div><div></div>Unit of an equity oriented mutual fund</div> <div><div></div>Zero coupon bond</div> | Less than 12 months       | 12 months or more |
| <div><div></div>Immovable property</div> <div><div></div>Unlisted shares</div>  | Less than 24 months       | 24 months or more |
| <div><div></div>All other assets including</div> <div><div></div>Units of business trust</div> <div><div></div>Unlisted bonds / debenture</div> <div><div></div>Gold</div>  | Less than 36 months       | 36 months or more |

In order to simplify the provisions for determination of period of holding, the Finance Bill, 2024 ("Bill") proposes to amend section 2(42A) of the ITA to provide for two holding periods as under:

| Type of asset   | Proposed period of holding |                   |
|---|----------------------------|-------------------|
|   | Short-term                 | Long-term         |
| <div><div></div>Any listed security on Indian stock exchange like listed equity share of an Indian company, listed debenture, units of business trust</div> <div><div></div>Unit of Unit Trust of India</div> <div><div></div>Unit of an equity oriented mutual fund</div> <div><div></div>Zero coupon bond</div> | Less than 12 months        | 12 months or more |
| <div><div></div>All other assets including</div> <div><div></div>Immovable property</div> <div><div></div>Unlisted shares</div> <div><div></div>Unlisted bonds / debenture</div> <div><div></div>Gold</div>   | Less than 24 months        | 24 months or more |

Rate of tax applicable on capital gains

The ITA provides for different tax rates for capital gains arising to residents and non-residents depending on the nature of asset being transferred. The Bill proposes to rationalize the tax rate on capital gains arising from transfers undertaken on or after July 23, 2024 for all category of assets. The rate of tax on LTCG has been proposed to be 12.5% for both listed and unlisted assets, irrespective of whether the transferor is a resident or non-resident.

Currently, section 112A provides for a 10% tax rate on LTCG arising on transfer of listed equity shares, units of equity-oriented fund and business trust (subject to satisfaction of certain conditions). On such asset classes, there has been an increase in the tax rate.

On the contrary, in relation to LTCG arising on other assets like unlisted shares, bonds debentures etc., the ITA provides for a 20% tax rate for residents and 10% tax rate for non-residents. The Bill proposes to provide that LTCG arising on unlisted shares shall be taxable at the rate of 12.5% irrespective of whether the gains arise to a resident or non-resident.

In relation to STCG on transfer of listed equity shares, units of equity-oriented fund and business trust, the Bill proposes to increase the tax rate from 15% to 20%.

We have summarized the changes in relation to tax rates below:

#### In relation to long-term capital assets

| Type of asset  | Residents                |  | Non-residents   |  |
|--|--------------------------|--|---|--|
|  | Current                  | Proposed                                   | Current   | Proposed   |
| ■ Listed equity shares                                       | 10% (without indexation) | 12.5% (without indexation)                 | 10% (without indexation and foreign exchange fluctuation benefit) | 12.5% (without indexation and without foreign exchange fluctuation benefit) <sup>6</sup> |
| ■ Units of equity oriented mutual fund                       |                          |  |   |  |
| ■ Units of business trust                                    |                          |  |   |  |
| ■ Unlisted equity shares                                     | 20% (with indexation)    | 12.5% (without indexation)                 | 10% (without indexation)  | 12.5% (without indexation and with foreign exchange fluctuation benefit)                 |
| ■ Unlisted bonds / debentures (see further discussion below) | 20% (with indexation)    | Deemed as STCG taxable at applicable rates | 10% (without indexation)  | Deemed as STCG taxable at applicable rates   |
| ■ Immovable property   | 20% (with indexation)    | 12.5% (without indexation)                 | 20%   | 12.5%  |

#### In relation to short-term capital assets

| Type of asset                          | Residents                                       |          | Non-residents |          |
|--|---|----------|---------------|----------|
|  | Current   | Proposed | Current       | Proposed |
| ■ Listed equity shares                 | 15%   | 20%      | 15%           | 20%      |
| ■ Units of equity oriented mutual fund |   |          |               |          |
| ■ Units of business trust              |   |          |               |          |
| ■ Others                               | No change – STCG taxable at applicable tax rate |          |               |          |

#### Computation of capital gains

Section 48 in of the ITA provides for manner of computation of capital gains. Section 48 also provides for indexation of cost of acquisition for computation of LTCG arising on transfer of property, gold, unlisted assets etc. in hands of residents. The Bill proposes to remove the indexation benefit for computation of capital gains considering that tax rate on such LTCG has been reduced from 20% to 12.5%.

Further, section 48 also provided for computation of capital gains arising to a non-resident from transfer of shares or debentures of an Indian company considering the foreign exchange fluctuation benefit. Recently, the decision of Mumbai ITAT in the case of Legatum Ventures Ltd. vs Assistant Commissioner of Income-tax (International

Taxation)<sup>7</sup> stirred controversy on whether capital gains to a non-resident have to be computed considering foreign exchange fluctuations or not. The amendments proposed under the Bill may put an end to this controversy. As per

the amendments, LTCG in hands of a non-resident or foreign company is taxable at rate of 12.5%. Such LTCG has to be computed as per section 48, which provides for foreign exchange fluctuation benefit to non-residents.

Rationalization of the capital gains provisions was a long standing ask from industry participants. The amendments proposed by the Bill certainly simplify the capital gains tax regime and brings parity between resident and non-resident investors. The proposed amendments are likely to adversely impact FPIs who have exposure to Indian listed markets as the tax rate on LTCG has increased to 12.5% (from 10%) and STCG has increased to 20% (from 15%).

In context of sale of shares under an offer for sale (“OFS”), the selling shareholder gets the benefit of 10% tax rate under section 112A of the ITA (while period of holding for LTCG is considered as 2 years). However, considering that LTCG on listed shares was made taxable from February 1, 2018, cost step-up upto January 31, 2018 was provided to equity shares. In case where shares were not listed as on January 31, 2018 or shares became property of the taxpayer in consideration of shares which were not listed on January 31, 2018 by way of an exempt transfer and are subsequently listed, the Bill has proposed an amendment to section 55 to provide cost step-up by way of indexation of cost of acquisition of such unlisted shares being sold under OFS.

### 3. TAXATION OF UNLISTED BONDS AND DEBENTURES

In relation to unlisted bonds or debentures, the Bill proposes to amend section 50AA of the ITA to deem the capital gains arising on its transfer or redemption or maturity to be STCG in nature. Accordingly, any payment received by an investor on transfer or redemption or maturity of unlisted bond or debenture will be characterized as STCG and tax rate of such gains will be the tax rate applicable to such investor depending on its form and residency.

Typically, returns under a bond / debenture are structured as (i) interest payable during the tenure of such instrument representing a commercial rate of return and (ii) redemption premium is paid towards the capital risk being borne by the investor. Taxation of redemption premium has been a litigated issue in India. As per section 2(28A) of ITA, “interest” means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or charge in respect of moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized. On the plain reading of the aforesaid definition, it is observed that ‘interest’ under section 2(28A) does not specifically cover redemption premium. On the contrary, the definition of ‘interest’ under several tax treaties includes redemption premium. There have been contrary judicial precedents wherein courts have held that redemption premium is taxable as capital gains<sup>8</sup> in some instances and as interest<sup>9</sup> in some other instances.

Considering that proposed amendment under section 50AA, amount received upon maturity / redemption of bonds / debentures will be deemed to be STCG in nature under the provisions of ITA. In case of non-residents, where redemption premium is specifically included in definition of interest under the relevant tax treaty, one will have to analyze whether (i) non-resident can offer such amount received on redemption of bonds / debenture as interest (instead of STCG under section 50AA) or (ii) can claim exemption (if any) under capital gains article.

Lastly, amendment to section 50AA should not impact the ability of the Indian company to claim deduction of redemption premium paid as interest, subject to applicability of section 94B.

### 4. AMBIT OF ‘SPECIFIED MUTUAL FUND’ EXPANDED

Finance Act, 2023 deemed the capital gains arising from transfer of unit of a ‘specified mutual fund’ to be in nature of STCG. In this regard, ‘specified mutual fund’ was defined to mean a mutual fund (by whatever name called) which invests not more than 35% of its total proceeds in equity shares of domestic companies. The consequence of the amendment by Finance Act, 2023 was that capital gains arising from both debt and non-debt oriented mutual funds were deemed to be STCG in nature, taxable at applicable rates in hands of investor. Further, there was ambiguity on whether fund-of-funds will also be covered within the ambit of ‘specified mutual funds’.

Considering the above, the Bill proposes to amend the said definition to provide that specified mutual fund means (a) a mutual fund (by whatever name called) which invests more than 65% of its total proceeds in debt and money market instruments or (b) a fund which invests 65% or more of its total proceeds in units of a fund referred to in clause (a).

This is a welcome move and provides clarity on manner of taxation of gains arising on variety of mutual funds like gold funds, exchange traded funds (“ETFs”) etc. Such gains will continue to be characterized depending on the period of holding of the investor. As per the amended provisions of period of holding, (i) if the units are held for less than 24 months, gains arising from transfer will be characterized as STCG, taxable at applicable rates and (ii) if the units are held for 24 months or more, gains arising from transfer will be characterized as LTCG, taxable at 12.5% (without any indexation benefit).

In context of retail schemes<sup>10</sup> in IFSC (“IFSC Retail Fund”), the above amendment may lead to certain ambiguity. This is considering that the Budget also proposes to amend section 10(4D) to include a fund which has been granted a certificate as a retail scheme and is regulated under the FM Regulations to the definition of ‘specified funds’. Section 10(23FBC) of the ITA specifically exempts income arising from transfer of units of a ‘specified fund’ in hands of the unit holders. A retail scheme investing in debt may fall within the ambit of ‘specified mutual fund’ under section 50AA as well. However, considering that section 10(23FBC) specifically exempts income in hands of the investor, such income should not be subject to tax as per provisions of section 50AA. This is in line with the government’s intention of providing funds in IFSC the same (if not better) treatment as compared to an offshore fund.

### 5. TAX ON DISTRIBUTED INCOME OF DOMESTIC COMPANY FOR BUY-BACK OF SHARES

Under the Companies Act, 2013 (“CA”), there are two methods for a company to re-purchase its own shares:

1. Share buy-back, and
2. Capital reduction.

As per Section 68 of the CA, a company can buy-back its own shares subject to certain statutory restrictions.

The Finance Act, 2013 had introduced special provisions to tax the income distributed by a domestic company from



buy-back of shares, in line with the scheme of dividend distribution tax ("DDT"), at the rate of 20% plus surcharge and cess (in the hands of the domestic company).<sup>11</sup> To this extent, under the current tax regime:

1. shareholders are exempt from tax on the income received from the buyback of shares,<sup>12</sup> and
2. buy-backs are specifically excluded from the scope of 'deemed dividends' under the ITA.<sup>13</sup>

As a shift in this tax policy, and (partially) aligning with the taxation of a capital reduction, the Bill proposes to tax consideration paid on buy-back of shares as dividends in the hands of the shareholders (through addition of sub-clause (f) in the definition of 'dividends' in the ITA), with effect from October 01, 2024. However, whereas in the instance of a capital reduction, the treatment as dividend is to the extent of the companies accumulated profits; the entire consideration on the buy-back of shares is now being proposed to be characterized as dividends.

As per the Memorandum, the rationale is to bring parity in taxation of the incomes distributed to shareholders, as both (a) dividend distribution and (b) income distribution on buyback, are different methods for the company to distribute accumulated reserves. The logic is to therefore, to treat them similarly.

To this extent it is also proposed to dis-allow interest expense on such dividends paid by the company as deductions, while determining their 'income from other sources'.

Further, the 'full value of consideration' of such shares, has been deemed as nil; thereby allowing a capital loss to be booked in the hands of the shareholder (which they may carry forward as per the ITA), through an amendment in Section 46A. For shareholders subjected to a buy-back, and sitting on a capital loss on such shares at such point, they may set off such losses against existing or future gains. However, in the instance of shareholders not having gains to off-set at a future stage, the accumulation of losses may not be as helpful.

Appropriate amendments have also been suggested in Section 194, to subject the payment on buy-backs to withholding taxes at the hands of the domestic company.

A redemption of preference shares is arguably covered within the scope of Section 115QA (taxable at 20%). However, the proposed addition of sub-clause (f) in Section 2(22), makes a reference to payment by a company on account of a purchase of its own shares pursuant to Section 68 of the CA. Thus, in case of redemption of preference shares taking place under Section 55 of the CA, the taxability of consideration received on account of such redemption of preference shares should be as capital gain income.

Further, the explicit characterization of such payments as dividends for the purposes of the ITA, should imply the availability of treaty benefits (of reduced tax rates for dividend income), on such buy-back payments.

Lastly, for distributions being made by foreign companies, or funds, it may now be difficult to escape the characterization of its distributions as 'dividends' for the purposes of Section 2(22), given that an explicit amendment has been proposed to include distributions made by such companies subject to Section 68 of the CA. While, given that the language requires the company to make distributions subject to Section 68 of the CA (which foreign companies/funds may not be subject to), one may still argue for the characterization of such income as capital gains in the hands of the recipient; though, the intent of the law may not favor such interpretation.

## 6. TAX INCENTIVES FOR UNITS IN IFSC

### IFSC Retail Funds

With the simplest of amendments, the Government intends to provide much needed clarity and tax parity for IFSC Retail Funds. Specifically, the Bill proposes to amend the definition of "specified fund" under ITA to include a "*fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate, which has been granted a certificate as a retail scheme...and is regulated under the International Financial Services Centres Authority (Fund Management) Regulations, 2022*"

Currently, the taxation of IFSC Retail Funds depends on whether they are set up as companies or trusts. However, by including them within the definition of "specified funds", the Government intends to afford these retail funds the same tax treatment as Category III AIFs set up in GIFT City regardless of their corporate structure.

A few of the significant tax benefits which will now be afforded to IFSC Retail Funds include (*inter alia*) exemption on income received by such fund from:

1. the transfer of certain securities listed on an IFSC exchange, including rupee denominated bonds of an Indian company, derivatives, foreign currency denominated bonds and equity shares of a company, etc ("Specified Securities").
2. the transfer of securities (other than shares in a company resident in India)
3. securities issued by a non-resident (not being a permanent establishment of a non-resident in India) and where such income otherwise does not accrue or arise in India; and
4. a securitisation trust which is chargeable under the head "Profits and gains of business or profession"

Moreover, any income received by non-resident investors from its investment in the IFSC Retail Fund or from the transfer of the units of the IFSC Retail Fund will also be exempt in the hands of such investors. Non-resident investors will not be required to obtain a PAN or file income tax returns.

Along with IFSC Retail Fund, the Bill also proposes to include ETFs within the definition of specified funds. However, it should be noted that in order to qualify for the tax benefits afforded to specified funds, all the units of the IFSC Retail Fund (other than those held by manager / sponsor) must be held by non-residents.

### Finance Companies (i.e. NBFCs)

Section 94B of the ITA puts in place a restriction on Indian companies (and permanent establishments of foreign companies (PEs)) with respect to deduction of interest expense in respect of any debt issued by a non-resident which is an associated enterprise of such Indian company (or PE). Specifically, if the Indian company (or PE) incurs any

expenditure by way of interest or of similar nature exceeding INR one crore, the interest deductible is restricted to the extent of 30% of its earnings before interest, taxes, depreciation and amortisation. This restriction was intended to avoid thin capitalisation of a corporate entity.

At present, the restriction on deductible interest does not apply to Indian companies (or PEs) which are engaged in the business of banking or insurance or “such class of non-banking financial companies as may be notified by the Central Government.” The Bill now proposes to notify that this restriction will not apply to finance companies (i.e. NBFCs), located in the IFSC at GIFT City and registered with IFSCA under the IFSCA (Finance Company) Regulations, 2021.

#### Rationalisation of Certain Provisions

Currently, under section 10(23EE) of the ITA, certain income of Core Settlement Guarantee Funds is exempt, but only if such Core Settlement Guarantee Funds are set up by clearing corporations registered with SEBI. Recognizing that the IFSC also has two clearing corporations of its own, the Government has proposed to amend section 10(23EE) of the ITA to cover for Core Settlement Guarantee Funds set up by clearing corporations registered with the IFSCA.

Similarly, Section 68 of the ITA currently provides that where any sum is found to be credited in the books of a tax payer, and the tax payer offers no explanation about the nature and source thereof, or the explanation offered by him is not satisfactory, the sum so credited may be charged to income-tax. Further, the nature and source of any liability credited in the books of the taxpayer is treated as explained only if the source of funds is also explained in the hands of the creditor. However, this additional onus of proof of satisfactorily explaining the source in the hands of the creditor, is not applicable if the creditor is a Venture Capital Fund (VCF) or Venture Capital Company (VCC) registered with SEBI. The Bill now proposes to extend this relaxation to VCFs registered with IFSCA.

All of the above-mentioned proposed amendments are intended to take effect from April 1, 2025 and will, accordingly, apply in relation to the AY 2025-26 and subsequent AYs.

#### Conclusion

While, all of the proposed amendments are targeted to the further promotion of the IFSC, the inclusion of IFSC Retail Funds as specified funds under the ITA is a critical change that should provide much required tax certainty to retail investors looking to invest in GIFT.

As the current framework taxes IFSC Retail Funds as per their corporate structure, there is the potential for disparity of taxation amongst domestic mutual funds vis-a-vis retail funds in IFSC, thereby leading to ambiguity and tax uncertainty for retail investors looking to invest in the IFSC. For certain structures, like a company, there is even the potential of double taxation, once at the fund level and again at the investor level.

Moreover, when compared to the single layer of taxation afforded to Category I, Category II and Category III AIFs set up in the IFSC (“**IFSC AIFs**”), and to mutual funds set up in India (outside of the IFSC), IFSC Retail Funds were at an obvious disadvantage. With the proposed amendment to include IFSC Retail Funds within the ambit of specified funds, the Government has provided much needed tax parity which should boost non-resident retail investment into the IFSC.

That being said, despite providing clarity with respect to IFSC Retail Funds and ETFs set up in the IFSC, the Government has missed this chance to provide the same clarity with respect to Family Investment Funds (“**FIFs**”). Similar to how IFSC Retail Funds are currently taxed (prior to the proposed amendment under the Bill), any FIF set up in the IFSC will also be taxed according to its corporate structure. In other words, an FIF set up as a company will be taxed differently than one set up as an LLP or one set up as a Trust. Noting that this issue was first resolved for Category I and Category II IFSC AIFs, and then for Category III IFSC AIFs, and now for IFSC Retail Funds and ETFs, it seems that the Government will continue to take a piecemeal approach when it comes to providing tax certainty in the IFSC.

Along similar lines, the current Budget would have also been an opportune time to amend the ITA in order to provide tax exemption to non-residents with respect to income from insurance policies obtained from the IFSC. While income received by non-residents from other financial products like IFSC AIFs, retail funds, certain securities, etc. have been exempted, income from insurance policies sold in the IFSC continues to be taxable in the hands of non-resident investors.

In order to further promote offshore investment, particularly from retail investors which would also deepen the IFSC’s capital markets, the Government may have considered providing an exemption for non-residents on dividend income received from securities listed on the IFSC exchanges. Keeping in mind that the ITA already provides an exemption from capital gains tax in the hands of non-residents with respect to gains earned from the transfer of certain notified securities listed on IFSC exchanges, it seems incongruous to continue to tax dividend income received from those same listed securities. Moreover, while non-residents investing in other financial products offered in the IFSC, like units of IFSC AIFs, are specifically exempted from obtaining a PAN or filing income tax returns, the requirement to pay tax on dividends adds an extra burden on non-resident investors in terms of compliances and deters investment into securities listed on the IFSC exchanges.

## 7. ANGEL TAX ABOLISHED

Finance Act, 2012 introduced the infamous ‘Angel tax’ under section 56(2)(viib) of the ITA to prevent circulation of black money. Section 56(2)(viib) imposes a tax liability on unlisted companies on receipt of consideration for the issuance of shares to the extent the consideration exceeds the fair market value of the shares of such company. The excess consideration received by such companies is taxable as income from other sources. The applicability of Angel tax was initially limited to investments received from residents of India. The Finance Act, 2023 extended its applicability to investments made by non-resident investors as well.

The introduction of angel tax created a lot of controversies and posed substantial challenges for companies as well as investors. Further, angel tax provisions gave rise to litigation as tax authorities started challenging the valuation methodology adopted by taxpayers.

The Bill proposes to abolish angel tax from FY 2024-25. Elimination of angel tax will increase capital availability with companies and simplify investment structures. It is a positive step towards creating a conducive environment for



companies especially startups in India. Abolition of angel tax shows governments intention and commitment to attract foreign capital to India. However, this amendment is prospective in nature and angel tax provisions will continue to apply for past investments.

It is pertinent to note that while Angel tax is being proposed to be abolished, section 68 continues to exist. Section 68 of the ITA was introduced along with Angel tax and the memorandum to the Finance Act, 2012 categorized both of these amendments as "Measures to Prevent Generation and Circulation of Unaccounted Money." Section 68 provides that if any sum is found credited in the books of the taxpayer and the taxpayer offers no explanation about the nature and source of the income and the explanation offered (in the opinion of tax authority) is not satisfactory, the credited sum may be charged to tax as the income of the taxpayer of that previous year. Further, the second proviso to section 68 casts an additional onus on the companies to prove 'source of the source' with respect to sums credited in the nature of share application money. In the past, the tax authorities have initiated simultaneous proceedings under section 68 and section 56(2)(viib). While the removal of angel tax is a positive step towards supporting startups, litigation under section 68 may continue to haunt legitimate investments.

## 8. INTRODUCTION OF PERIOD OF LIMITATION FOR TDS PROCEEDINGS ON NON-RESIDENTS

Section 201 of the ITA provides that a taxpayer can be deemed to be 'assessee-in default' ("**AID**") in case where such person does not deduct tax or after deducting, does not deposit the deducted tax in accordance with the provisions of the ITA. In this regard, section 201(3) provides that no order under section 201 deeming a person to be AID shall be passed at any time (i) after the expiry of 7 years from the end of the FY in which payment is made or (ii) 2 years from end of FY in which the correction statement under section 200(3) is delivered, whichever is later. The aforesaid timeline is currently provided for defaults on payments made to a person resident in India. The Memorandum to the Finance Act, 2009 through which the timeline was introduced in the ITA noted that "*no time-limits have been prescribed for order under sub-section (1) of section 201 where (c) the deductee is a non-resident as it may not be administratively possible to recover the tax from the non-resident.*"

Therefore, in context of non-residents payees, there has been a controversy on the limitation period applicable for initiation of TDS proceedings on the payor. In this regard, certain judicial precedents have held that the limitation applicable in respect of resident payees should apply for non-resident payees as well.<sup>14</sup> Recently, the Telangana High Court in case of *Ariba Inc. v. DDIT, International Taxation*<sup>15</sup> held that since the legislature had not prescribed any time limit for an order under section 201 to be passed in case of payment made to a non-resident, it would be wrong on its part to read such a limitation into it. However, the Telangana High Court held that such an order qua a non-resident payee should be passed within a reasonable period.

In order to bring an end to this uncertainty in context of payments made to non-residents, the Bill proposes to amend section 201 to provide that a timeline for issuance of order under section 201 in case of payments made to non-residents as well. The Bill proposes to provide for a statutory timeline of 6 years from end of FY in which payment has been made for passing of order under section 201. This ties in with the reduced limitation period for re-opening of assessments under section 148 of the ITA.

This amendment brings an end to the debate on the statutory period of limitation applicable for TDS proceedings in relation to payments made to non-residents. It is likely to impact negotiation of transaction documents wherein payments are being made to non-residents. Considering that the statutory period of limitation under the ITA for both residents and non-residents has been amended to 6 years, tax indemnities along with indemnity cap may be negotiated for upto 6 years.

## 9. RATIONALIZATION OF DIFFERENT TAX REGIMES FOR CHARITABLE TRUSTS

The ITA sets out two parallel regimes for granting tax benefits and exemptions to the not-for profit space in India (i.e. trusts and institutions that fulfill a 'charitable purpose'):

1. Sub-clauses (iv), (v), (vi), & (via) of Section 10(23C);
2. Sections 11 to 13.

Over the last few years, the two regimes have been broadly aligned so as to remove any disparity of treatment between charitable entities registered under either of the tax exemption frameworks. The recent flow of changes in rules and operational guardrails introduced by the Finance Act, 2022, and Finance Act, 2023, thus, apply to both regimes.

To take this a step forward, the Bill has set out the mechanism for merging the two regimes, such that the previous Section 10(23C) regime shall no longer be available for charitable entities seeking a tax-exempt registration, post October 01, 2024. Such (new) entities will have to place their registration applications under the new regime set out in Section 12A. For those holding valid registrations (or pending applications) under the extant Section 10(23C) framework, such registrations will continue to be kosher through the period of its validity (with the option to re-apply under the new regime upon the expiration of such registrations).

Given the complexity of the tax framework (in both these regimes) applicable to such charitable entities, to retain their tax-exempt registrations – the consolidation of the regimes into a more cogent structure will definitely be welcome by those operating within the myriad of regulations applicable to the not-for profit space.

Further, not-for profit organizations in India are usually subject to heightened scrutiny under a number of regulatory frameworks in India. To this extent, while on the face of it the ITA (specifically under Sections 11-13) simply sets out the conditions which such entities need to mandatorily adhere to (to avail the tax-exempt status); in effect, it delineates the entire operative playground within which these non-for profit entities need to operate in. A failure to do so, often leads to either a cancellation of their tax-exempt registrations, or liability to pay an additional tax on their 'accreted income' (over and above the tax payable on their income), at the maximum marginal rate of 30%, under chapter XII-EB of the ITA. For this purpose, the 'accreted income' is defined to include the amount by which the aggregate fair market value (FMV) of the total assets of such charitable entity (as on a 'specified date'), exceeds the total liabilities of such person – computed in accordance with the prescribed valuation rules. A simple failure to renew the registration within stipulated timelines may also lead to this result.

In order to prevent undue difficulties to such entities that are unable to meet the timelines, the government has proposed to enable the tax officer with the power to condone the delay (subject to there being a 'reasonable cause'). One may argue that the subjectivity of this determination in the hands of the revenue, adds to their discretionary powers to grant and cancel tax registrations of not-for profit entities.

Beyond this, not-for profit entities (with tax exemptions under either regimes), merging into other registered non-profits, may lead to a tax on their 'accreted income' at 30%, unless the other not-for profit entity also has similar objects and is registered/approved. To this extent, a new provision (Section 12AC) has been introduced, to ensure that on such mergers where (a) both entities are registered under either regimes (not necessarily the same), and (b) have same or similar objectives, Chapter XII-EB should be inapplicable. While this appears to be a clarificatory provisions, which explicitly ascertains the position already set out in Section 115TD (i.e., Accreted Income); the new provision has also set out a requirement for the merger to fulfil such conditions as may be prescribed (i.e., in addition to (a) and (b) above). One will have to wait and watch as to how such conditions may simplify or further burden such NPOs contemplating a merger. Further, mergers of charitable trusts, under applicable trust laws (and the taxability of transfer of assets as a consequence) also need to be examined in this context.

Lastly, while the changes are helpful, this Bill does not seem to have addressed concerns of the social sector industry with respect to unrestrained powers of the revenue to cancel tax exempt registrations at their discretion (specifically in Section 12AB(4)).

## 10. TRANSFER OF CAPITAL ASSETS UNDER GIFT OR WILL OR AN IRREVOCABLE TRUST

Under section 45 of the ITA, only gains arising from the *transfer* of a capital asset are subject to capital gains tax. Section 47(iii) of the ITA states that a 'transfer' of a capital asset under a gift or will or an irrevocable trust will not amount to a transfer as required under section 45. Currently, section 47(iii) does not provide any restrictions with respect to who / what can make or receive a gift. Accordingly, even though under the Indian Contract Act, 1872, gifts are to be made out of natural love and affection between parties, tax payers have argued in the past that the transfer of shares (or other capital assets) by or to a company without consideration amounts to a gift under section 47(iii) of the ITA and is therefore not subject to capital gains tax. This stance has led to increased litigation, tax uncertainty and possible tax avoidance and tax base erosion. To address these concerns, the Government has proposed to limit section 47(iii) to only those transfers of capital assets under gift, will or irrevocable trust executed by individuals of HUFs.

Once the amendment takes effect on April 1, 2025, companies, LLPs and other corporate entities will no longer be able to claim exemption from capital gains tax for the gift of any capital asset, including shares of a company. Moreover, the settlement of shares into irrevocable trusts which are commonly used by companies to facilitate the granting and vesting of ESOPs (i.e. ESOP Trusts) may also become taxable.

This amendment is in line with the Government's historic efforts to eliminate avoidance of capital gains tax.

## 11. LITIGATION UPDATES AND REVAMP OF PROCESSES

Through Finance Act, 2021, the provisions pertaining to re-assessments were overhauled with an intent to simplify and rationalize the procedure and ultimately reduce litigation. The primary change was that the standard for initiating re-assessment was amended from the tax officer having 'reason to believe' that income has escaped assessment to having 'information which suggests' that income has escaped assessment. Further, statutory checks and balances were introduced for tax officers to initiate such reassessment including the requirement for conducting an inquiry, issuing a show-cause notice ("SCN") to allow the taxpayer to show cause why the re-assessment proceedings should not be initiated, obtaining approvals from specified authority and issuing an order ("148 Order") declaring the case fit to be reopened before issuing a notice to reopen the assessment under section 148 of the ITA ("148 Notice"). Pursuant to issuance of 148 Notice, the taxpayer is granted 3 months' time to file its return, which then becomes the basis for initiating the scrutiny.

The limitation period for issuance of notice for re-assessment notice was also revised to be in the range of 3 to 10 years from the end of the relevant AY (from the erstwhile range of 4-6<sup>16</sup> years) depending on the circumstances.

In continuation of its efforts to simplify the provisions for re-assessments, and bearing in mind stakeholder concerns, this Budget has proposed further changes to the scheme of re-assessments.

Some of the key changes introduced are as follows:

- **Show-cause notice:** The SCN to be issued to the taxpayer shall be accompanied with the 'information which suggests' that income has escaped assessment. It was ruled in several case laws that if the 'information' relied upon by the tax officer to initiate the re-assessment proceedings was not provided to the taxpayer along with the SCN, it would affect the ability of the taxpayer to effectively respond to SCN thereby violating principles of natural justice. The fact that such a requirement has been added to the statute to bring about certainty on this aspect is a welcome move.
- **Limitation period:** Under the existing provisions, the general time-limit for issuance of 148 Notice is 3 years from the end of the relevant AY. However, in a situation where the tax officer has in his possession books of accounts or other documents or evidence which reveal that the income chargeable to tax, represented in the form of an asset, expenditure in respect of a transaction or an event, or entries in the books of accounts which has escaped assessment amounts to or is likely to amount to 50 lakhs or more ("**Exception**"), the time limit is 10 years from the end of the relevant AY. The Budget proposes to reduce the limitation period for the Exception from 10 years to 5 years from the end of the relevant AY.

Under the existing provisions, while there is a limitation period for issuance of a 148 Notice, there is no limitation period for issuance of the SCN. To afford clarity and certainty in this regard, the Budget proposes to introduce a limitation of 3 years and 5 years for the SCN from the end of the relevant AY, as the case may be for issuance of SCN and provide a limitation period of 3 years 3 months and 5 years 3 months, as the case may be, for the time to be taken between (buffer of 3 months) the issuance of the SCN and issuance of the 148 Notice. With respect to the Exception, until this change in law, reassessment could have been initiated for AY 18-19 and earlier assessment years under the 10-year timeline. However, with the new timeline, the period to initiate reassessment for AY 18-19

and earlier years would have elapsed unless the 148 Notices or SCN is issued prior to 1<sup>st</sup> September 2024, which is when this new timeline comes into effect.

These changes in the limitation period, particularly the outer limit being limited to 5 years are a welcome move and is likely to make negotiations on tax clauses in transaction documents easier.

Board of Advance Rulings (“**BAR**”): a less desirable avenue

The authority for advance rulings (“**AAR**”), a tribunal constituted to essentially provide advance rulings to non-residents taxpayers on matters related to income tax implications in India, was abolished in 2021 and replaced with the BAR. All the matters pending with the AAR were automatically transitioned to the BAR and the same provisions which were applicable to the AAR were made applicable to BAR, read along with a specified scheme for the BAR. Given that the BAR is presided over only by revenue members (as opposed to judicial members in case of the AAR) and that the BAR rulings (unlike the AAR) are not binding, lot of applicants wished to withdraw their advance ruling applications. However, the provisions for withdrawal allowed for such withdrawal only within 30 days of filing the AAR application, which in all cases had elapsed. This was an unintended consequence of the change in law and to correct that a proviso has been introduced to both sections 245Q and 245R to allow for the withdrawal of these transferred applications before October 31, 2024. This is a welcome move as a lot of taxpayers were facing challenges in something as simple as withdrawing an advance ruling application.

Relaxation of onerous prosecution provisions for defaulters

Section 276B of the ITA provides for prosecution in case of delay in deposit of taxes withheld as per the prescribed due dates. The due dates for deposit of taxes is 7<sup>th</sup> day of the month following the month in which taxes are withheld (30<sup>th</sup> April in case the taxes are withheld in the month of March). While such a provision by itself is harsh and should be struck down entirely, this Budget has provided some relaxation by proposing that no prosecution shall be initiated if the taxes are deposited prior to the due date of filing the quarterly TDS tax returns. While this provides some buffer and relaxation, the expectation was and continues to be for this provision to be further diluted to avoid the instances of genuine taxpayers missing the deadlines for such deadlines inadvertently being exposed to prosecution.

Vivaad se Vishwas Scheme – an attempt to reduce litigations

The ITA provides for a comprehensive mechanism for appeal with respect to orders passed by the tax officers. There has been an increased number of cases instituted at the higher levels, all the way up-to the Supreme Court of India. The increase in litigation across different levels is primarily due to a higher number of cases being appealed compared to those being resolved. Taking inspiration from the success of the earlier Vivaad Se Vishwas Act, 2020, and considering the growing backlog of appeals at the first appellate level, the introduction of the Direct Tax Vivaad se Vishwas Scheme, 2024 is being proposed. It aims to offer a mechanism for resolving contentious issues by way of settlement, thereby reducing litigation.

Search and seizure

The procedure relating to search and seizure proceedings initiated against the taxpayer was subsumed within the ambit of the erstwhile reassessment provisions (section 148 to 151 of the ITA). Owing to several complications arising out of such clubbing, the Budget has proposed to revert to the earlier regime of having a separate chapter for conducting search and seizure proceedings.

## 12. 2% EQUALIZATION LEVY REMOVED

The advent of OECD's Two Pillar solution (from its inception in as BEPS Action Plan 1, in 2015; and as the Two Pillar solution in 2019), was to address two key concerns within the international tax law framework:

1. Pillar 1: Redistribution of taxing rights to market jurisdictions, which is where significant value is created on account of the market base (especially in cases where entities were not physically present in such market jurisdictions but were nonetheless engaging with and generating revenue from such markets); and
2. Pillar 2: Incorporating a global minimum tax rate, to prevent a race to the bottom.

However, given the tedious global negotiations between participating countries of the OECD Inclusive Framework to arrive at consensus for the Two Pillar solution - several countries, along with India, introduced 'digital services tax' (or the 'Equalization Levy' in India “**DST or EL**”), to tax revenues generated by overseas companies from market jurisdictions (in the absence of physical presence, as would be required under the current treaty framework).

India's EL was first introduced in 2016 to tax the consideration received by a non-resident for provision of specified online advertising service, at the rate of 6% (with the intention to 'equalize' or create an equal playing field for non-residents and residents) (“**Advertisement EL**”). The scope of the EL was subsequently expanded in 2020 to tax (at the rate of 2%) the consideration received/receivable by non-resident e-commerce operators from e-commerce supply or service provided to (a) residents of India, (b) persons buying such goods or services using an Indian IP, or (c) non-residents in certain limited circumstances (“**E-comm EL**”). If any income being paid to a non-resident from India was first not taxable as royalty or fee for technical services (FTS) under the ITA, then same could be taxed under the E-Comm EL (to the extent such a payment was captured within its scope). To this extent, Section 10(50) offered an exemption to such income from tax under any provisions of the ITA, once the income was subject to the E-Comm EL (as per Section 165A of the Finance Act of 2020).

In line with the suggested interim approaches in BEPS Action Plan 1, the E-Comm EL served as a stop-gap solution to tax non-residents generating value and revenue from Indian markets, without physically setting up shop in India. However, the E-Comm EL faced severe backlash from the US, in the form of investigations under Section 301 of the Trade Act of 1974, USA, initiated by the Office of the United States Trade Representative (“**USTR**”). This was followed by the imposition of tariffs on a number of exports from India (and other countries which had introduced their own DSTs).

Subsequently, such other countries, and the USA issued a joint statement on a political compromise reached regarding the EL/DSTs on October 21, 2021.<sup>17</sup> This was followed by a press statement on November 24, 2021 from

the Indian Ministry of Finance, stating that the joint statement and its considerations shall be applicable to India as well.<sup>18</sup> Thus, India (along with others) assured to withdraw E-Comm EL upon, and subject to, Pillar 1 coming into effect. As per the agreement, excess E-Comm EL paid by MNEs subject to Pillar 1 was also to be available as credit for set off against their corporate tax liability determined under Pillar 1. The credit was to be given for E-Comm EL paid by MNEs from April 1, 2022 till implementation of Pillar One or March 31, 2024, whichever is earlier (i.e., the “Interim Period”). In return, the USA agreed to terminate proposed trade actions, and not to impose any new trade actions, until the end of the Interim Period. Subsequently, on June 28, 2024, a joint statement between India and USA was released extending the Interim Period till June 30, 2024.<sup>19</sup>

Post the Interim Period elapsing, there could be one of 2 consequences:

1. If Pillar 1 has entered into force, India would be obligated to remove the E-Comm EL;
2. If Pillar 1 has not entered into force, India would not be obligated to remove E-Comm EL. However, USA would also not be restricted from imposing any new trade sanctions (for which it was only restricted till the end of the Interim Period). This would effectively result in the same situation as 2021, i.e., India imposing its E-Comm EL, and USA imposing trade sanctions as a response.

The realities of the current negotiations between the OECD Inclusive Framework members, display a far bleaker reality for Pillar 1. With India, specifically refusing to negotiate on the current (and severely different) scope of Pillar 1, as compared to 2021, the possibility of global consensus on Pillar 1 does not appear to be anywhere near sight (if at all). While the FM made no references or comments during her budget speech, in respect of the two pillar solution, in a post budget press conference, the FM has expressed that the removal of the E-comm EL is in the interest of proceeding towards the Two Pillar Solution. Thus, despite the lack clarity on the future of Pillar 1 at the moment, the Bill has proposed to abolish the applicability of the E-Comm EL with effect from August 01, 2024.

### 13. RATIONALIZATION OF TDS

The Bill proposes to reduce TDS rates on certain payments to improve ease of doing business and better compliance by taxpayers. It is pertinent to note that no change in rate has been proposed with respect TDS on salary, virtual digital assets, winnings from lottery, payment on transfer of immovable property, etc. Tax rates have been reduced inter-alia for commission payments, rental payments, payment for contract work etc. TDS rate under section 194-O has also been proposed to be reduced to 0.1% from the current 1%. This is a welcome step as reduced rates of TDS will ensure additional income in the hands of the recipients (especially individuals). Reduced rate of TDS will incentivize compliances as it reduces burden on taxpayers, making tax payment and compliance less onerous. Overall, this will help in providing taxpayers with more financial flexibility and reduce immediate tax outflows.

### 14. AMENDMENTS UNDER GOODS AND SERVICE TAX

#### (a) Revamping GST assessment procedures

Assessment under the Central Goods and Service Tax Act, 2017 (“CGST Act”) is governed by section 73 and section 74. Section 74 dealt with cases involving fraud, willful misstatement, or suppression of facts (“Fraud Cases”), and provides time limit of 5 years from the date of filing the annual return to complete assessment. Section 73 applies to cases other than those involving fraud, willful misstatement, or suppression of facts (“Non-fraud Cases”) and provides a time limit of 3 years from the date of filing the annual return to complete assessment.

Amendments to the CGST Act have revised these provisions to standardize the assessment timelines from FY 2024-25 onwards. Section 74A has been introduced, stipulating a common time limit of 3.5 years and 4.5 years from the date of filing the annual return for issuing notices and passing assessment orders for all cases. In relation to application on penalty, section 74A provides for a penalty of (i) 10% of taxes due or INR 10,000, whichever is higher, in Non-fraud Cases; and (ii) 100% of tax due in Fraud Cases.

Considering the current provisions provided for an extended period of limitation for Fraud Cases, several show cause notices were challenged on jurisdictional grounds, primarily because of the subjectivity involved in the phrase “fraud, willful misstatement, or suppression of facts”.

While this change is expected to reduce litigation related to jurisdictional disputes, it also means that the time limits for all cases will be governed by the new standard provisions, affecting the duration and scope of GST assessments.

#### (b) Relief due to common trade practices

The GST Council in its 53rd meeting proposed to insert a provision to regularize non-levy or short levy of GST due to common trade practices. Consequently, the Bill has proposed to insert Sections 11A and section 6A in the CGST Act and the Integrated Goods and Services Tax Act, 2017 (“IGST Act”) respectively. In essence, both these provisions allow the Government to waive any non-levy or under-levy of GST due to ‘common trade practices’ by way of notifications. However, at this stage, it is not very clear what will be included in ‘common trade practices’. Further, it is not clear how the government will ‘regularize’ non-levy / short-levy of GST i.e. whether GST will be completely waived or whether GST waiver would depend upon payment of certain interest / penalty.

The aforesaid sections may be relevant for online gaming operators who were discharging GST on the service fee charged by them at rate of 18% on basis of interpretation of the GST provisions and legal opinions taken. Currently, online gaming operators face huge GST demand on basis of GST department alleging that GST was payable on the amount deposited with such operators at rate of 28%. It will have to be seen whether the government issues a notification under the proposed new sections to regularize the non-levy of GST in case of online gaming operators.

- International Tax Team

You can direct your queries or comments to the Authors.

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<sup>1</sup> At the time of the Interim Budget announced on February 1, 2024, the Government had set the target to reduce fiscal deficit from 5.9% of the GDP to 5.1% by FY 2024-25 and 4.5% by FY 2025-26

<sup>2</sup> In the Interim Budget, it was announced that as part of ensuring inclusive growth and development, the Government would focus on 4 major castes, namely Garib (Poor), Mahilayen (Women), 'Yuva' (Youth) and 'Annadata' (Farmer)

<sup>3</sup> The 9 Priorities include (1) Productivity and resilience in Agriculture; (2) Employment and Skilling; (3) Inclusive Human Resource Development and Social Justice; (4) Manufacturing and Services; (5) Urban Development; (6) Energy Security; (7)

<sup>4</sup> These schemes include benefits such as direct transfer of one month's salary to first time employees registered in the EPFO up-to INR 15,000, incentives to both employer and employee with respect to EPFO contributions for employment in the manufacturing sector, reimbursements to employers for EPFO contributions for new employees to incentivize them to onboard additional employees.

<sup>5</sup> Where the capital gains exceeds INR 1.25 lakhs.

<sup>6</sup> Exemption limit under section 112A increased to INR 125,000 from INR 100,000

<sup>7</sup> *Legatum Ventures Ltd. vs Assistant Commissioner of Income-tax (International Taxation)*, [2023] 149 taxmann.com 436 (Mumbai - Trib.).

<sup>8</sup> *Mrs. Perviz Chang Chuk basi vs. JCIT* (2006) (102 ITD 123), *Anarkali Sarabhai vs. CIT* (1997) (90 Taxman 509) (SC), *Kartikeya V Sarabhai vs. CIT* (1995) (95 Taxman 164) (SC), *Sath Gwaldas Mathurdas Mohata Trust vs. CIT* (1987) (33 Taxmann 328) (Bom).

<sup>9</sup> *Khushaal C. Thackersey vs ACIT*, I.T.A. No. 3679/Mum/2015; *Bennett Coleman & Co Ltd vs. ACIT* (ITA No. 569/Mum/2009 dated 21-01-2010)

<sup>10</sup> Retail schemes are schemes launched by registered FME (retail) for pooling money from all investors or a section of investors through an offer document for investment as per its stated investment objective in various permissible investments

<sup>11</sup> Section 115QA, ITA

<sup>12</sup> Section 10(34A), ITA

<sup>13</sup> section 2(22)(iv), ITA

<sup>14</sup> The High Court of Delhi in case of *Bharti Airtel v. Union of India* [2017] 291 CTR 254 (Delhi) has held that the limitation period prescribed under section 201(3) of the ITA would be equally applicable in respect of non-resident

<sup>15</sup> *TS-583-HC-2023(TEL)*

<sup>16</sup> 16 years in case of income in relation to any asset located in India having escaped assessment.

<sup>17</sup> [home.treasury.gov/news/press-releases/jy0419](https://home.treasury.gov/news/press-releases/jy0419)

<sup>18</sup> [pib.gov.in/PressReleaseDetail.aspx?PRID=1774692](https://pib.gov.in/PressReleaseDetail.aspx?PRID=1774692)

<sup>19</sup> [pib.gov.in/PressReleaseIframePage.aspx?PRID=2029336](https://pib.gov.in/PressReleaseIframePage.aspx?PRID=2029336)

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