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ANALYSIS OF KEY DIRECT TAX PROPOSALS IN FINANCE BILL, 2020

Hon'ble Finance Minister delivered an extremely long innings for her Budget Speech. Under the guise of simplifying the provisions of the Act, the Hon'ble FM has introduced over 100 amendments in the Finance Bill, 2020 which may have resulted in more complications than the previous version of the direct tax law.

We have analysed some of the significant Direct Tax proposals as under:

1. Special concessional regime of taxation of Individuals / HUF

1.1. Section 115BAC is proposed to be introduced for individual and HUF assessees applicable for the financial year ended 31 March 2021 i.e. AY 2021-22 and subsequent years. As per the said provision, an individual / HUF shall have an **option** to avail concessional tax rates based on the slab of income as tabulated below. A comparison of the erstwhile tax rates with the proposed ones are also tabulated below:

Slabs of income (Amt in Rs)	Rate of tax (current)[1]	Rate of tax (proposed)[1]	Cumulative Tax Savings[2] (Amt in Rs)
Upto 2,50,000*	Exempt	Exempt	-
2,50,001 to 5,00,000	5.20%[3]	5.20%[2]	-
5,00,001 to 7,50,000	20.80%	10.40%	26,000
7,50,001 to 10,00,000	20.80%	15.60%	39,000
10,00,001 to 12,50,000	31.20%	20.80%	65,000
12,50,001 to 15,00,000	31.20%	26.00%	**78,000**
15,00,001 and above	31.2% (plus surcharge, if applicable)	31.2% (plus surcharge, if applicable)	-

**In respect of Senior Citizens (aged 60 years & above), the basic exemption limit is unchanged at ₹ 3,00,000 instead of ₹ 2,50,000 and in case of Super Senior Citizens (aged 80 years & above), the basic exemption limit remains unchanged at ₹ 5,00,000 instead of ₹ 2,50,000.*

[1] Including health and education cess of 4%
[2] Tax savings are illustrative and would be subject to satisfaction of the conditions laid down in the new provisions.
[3] Those earning total income upto Rs 5,00,000 would be eligible to claim to rebate

1.2. In order to avail the benefit proposed under the special tax regime, several conditions are required to be fulfilled which *inter-alia* include **forgoing of several exemptions / deductions.** We have listed certain pertinent ones as under:

(A) In case of person earning no business income –

- Leave travel concession as contained in section 10(5);
- **House rent allowance as contained in section 10(13A);**
- Exemption for SEZ unit contained in section 10AA;
- **Standard deduction, deduction for entertainment allowance and employment / professional tax as contained in section 16;**
- Interest under section 24 in respect of self-occupied or vacant property referred to in section 23(2).
- Loss under the head income from house property for rented house shall not be allowed to be set off under any other head but be allowed to be carried forward as per earlier law;
- **Any deduction under chapter VIA** (except for section 80CCD – contribution in NPS and section 80JJA)

The option to avail the benefit of concessional tax in the above case i.e. an individual / HUF having no business income, can be analyzed on a year-on-year basis depending upon the tax savings derived for each year.

(B) In case of person earning business income –

In addition to the above list, following deductions shall not be granted for individuals / HUF having income under the head – Income from Business & Profession:

- Additional deprecation under clause (iia) of sub-section (1) of section 32;
- Deductions under section 32AD, 33AB, 33ABA;
- Deduction for donation for or expenditure on scientific research under section 35(1) or 35(2AA); Deduction under section 35AD or section 35CCC;
- Brought forward Loss / unabsorbed depreciation attributable to such deductions shall not be allowed to be setoff.

In the above case i.e. an individual / HUF having business income, once the option to avail the benefit of concessional tax is exercised, there is no fallback provision to the normal rates. The assessee having exercised this option is granted exception of withdrawal for only one year; if the assessee wishes to withdraw this option even in the subsequent year (pursuant to

the exceptional year), the assessee shall not be allowed to pursue the concessional tax rates in any of such subsequent years[4].

IMPACT ANALYSIS

Non granting of deductions under Chapter VI-A (which includes deductions under section 80C, 80D, 80G, 80TTA, etc) and ineligibility to claim exemptions like HRA / LTA, etc are the major disincentives to avail such an incentive provision. Moreover, a comparison and analysis of the conditions basis which any person could determine whether or not the above concessional provisions are beneficial than the normal provisions would be required to be undertaken every year.

2. Abolishment of Dividend Distribution Tax ('DDT') and taxability of dividend income in the hands of shareholder / unitholders

2.1. Currently, companies are required to pay **DDT** on the dividend paid to its shareholders at an effective rate of **20.56%** (including surcharge and cess). This is in addition to the tax payable by the company on its profits. Further, such dividend income is exempt in the hands of shareholders section 10(34) upto Rs 10 lakhs and any excess thereof is chargeable to tax at a special rate of 10% under section 115BBDA. Further, the mutual funds declaring dividends were also subject to DDT under section 115R at differential rates and dividend received from such mutual funds were exempt in the hands of the unitholders under section 10(35). Similarly, business trusts are also required to pay DDT.

2.2. As per the proposed amendment, the dividend shall be taxed only **in the hands of the recipient shareholders / unitholders as per the tax rates applicable to them**. All the assessees are covered within its ambit. The companies and the mutual fund houses declaring / distributing / paying dividend **shall not be subject to DDT**.

2.3. **Foreign shareholders** would be required pay tax at 20% under the Act **(subject to availability of treaty benefits).**

2.4. Further, it is also proposed that any **deduction of expenses** (other than interest) which may be incurred towards earning such taxable dividend income **shall not be allowed** under section 57. In respect of any borrowing made for the purpose of investment in shares / mutual fund units by residents, the interest expenditure incurred thereon shall be allowed and **restricted only to the extent of 20%** of dividend income earned during the year.

[4] However, in case the assessee ceases to have any business income in any of the subsequent year/(s), he / she shall be entitled to exercise the beneficial option.

2.5. **Withholding tax** ('TDS') is re-introduced at the rate of 10% on payment of dividend in excess of Rs 5,000 in case of **residents**. In case of payments to non-residents, the TDS provisions under section 195 or 196A, 196C or 196D shall apply based on their respective category.

2.6. **Re-introduction of deduction under section 80M** - In order to eliminate **cascading effect** of taxation of dividend income in a multi-tier corporate structure, the dividend income shall be allowed to be setoff / reduced from the total income, if such dividend income is distributed onwards to another company one month prior to the due date of filing the return of income.

IMPACT ANALYSIS

(a) Removal of DDT is a welcome move. However, in case of individuals / HUF shareholders / unitholders being recipient of such dividend income, the earlier exemption of Rs 10 lakhs and the special tax rate of 10% applicable thereafter is removed and such dividend income would be added to the income slabs resulting in a higher tax burden. This would be especially burdensome in respect of dividend income from mutual fund units which was earlier exempt in the hands of the unitholders.

(b) Curtailing the deduction of expenses incurred for earning taxable dividend income and restricting interest expenditure against such dividend income also seem absurd.

(c) In relation to the cascading effect of dividend, it appears that no benefit is granted in relation to dividend income received from a foreign company and offered to tax under section 115BBD. Also, there's no contemplation of holding-subsidiary structure in order to avail this benefit and therefore, every form of holding should be covered.

3. Changes in conditions of residential Status of Indian citizens

3.1. Under the existing provisions of determination of residential status under section 6(1), if an NRI comes on a visit to India, he can stay in India overall for 182 days in a financial year and shall not be construed as a resident in India. **This period is proposed to be shortened to 120 days.**

3.2. Further, currently, if a person is a non-resident in 9 out of 10 years or during the preceding 7 financial years has been in India for under 730 days, he would be considered a Resident but Not Ordinarily Resident ('RNOR') and his income outside India is not liable to tax. The provision is amended to cover an individual who has been a Non-resident in 7 out of 10 preceding financial years to be considered as RNOR. The alternate condition of 730 days is now deleted.

3.3. A new provision is also proposed to be inserted based on which an **Indian citizen who is otherwise a non-resident** in India based on the criteria of no. of days' stay in India **but is also not liable to tax in any other country or territory shall be deemed to be resident** in India and consequently, liable to tax on his entire worldwide income.

3.4. However, just a day after the proposed amendment in the Finance Bill, by way of a Press Release dated 2 February 2020, the CBDT has clarified that in case of an Indian citizen who becomes deemed resident of India as per the above amendment, income earned outside India by him/her **shall not be taxed in India unless it is derived from an Indian business or profession**. It is pertinent to note that the **existing provisions already tax such income which is derived from Indian business / profession**.

IMPACT ANALYSIS

The non-resident Indian citizens based overseas but visiting India now cannot stay in India for more than 120 days in a year; else they'll be deemed to be residents and their global income might be subject to tax in India.
Further, in case of non-resident Indian citizens who are not liable to tax in any other country (for example UAE), based on the reading of the proposed amendment, it appeared that they'll be treated as residents of India and subject to tax in India on their global income. This may be an unintended consequence due to poor drafting of the provisions. The above apprehension is now clarified by way of the Press Release and one would wonder what purpose the proposed amendment could serve!

4. Tedious TDS and TCS provisions

4.1. **Section 206C** – Presently, the scope of tax collected at source (**'TCS'**) covers transactions in relation to sale of specified goods viz. motor vehicles, alcohol, liquor, forest produce, scrap, etc. It is proposed to widen the ambit of TCS and include following transactions which shall be subject to TCS:

(a) On **remittance** of sum in excess of Rs 7 lakhs under the **Liberalised Remittance Scheme** at the rate of 5% (10% for non-PAN / non Aadhar cases);
(b) On selling of any **foreign travel** package by a tour operator which includes **ticket bookings or hotel bookings** or other expenses in connection with overseas tour at the rate of **5%** (10% for non-PAN / non Aadhar cases).
(c) On every sale of goods exceeding Rs 50 lakhs at the rate of 0.1% applicable to sellers having turnover / gross receipts in excess of Rs 10 crores in immediately preceding financial year. This provision shall not apply to goods already covered in existing provisions of section 206C or in a case where the buyer is liable to withhold tax under any other provision

or certain specified categories of buyers. Further, in case the buyer doesn't hold a PAN / Aadhar, TCS at the rate of 1% would apply.

IMPACT ANALYSIS

The burden of collecting TCS on such transactions and filing the returns increases with this provision especially for a trader having high volume of sale transactions. There is also no relaxation for exports and this would result in liquidity issues and higher cost of transacting overseas. In the pretext of Big Data Analysis which our Hon'ble FM mentioned in the Budget Speech, this kind of compliance puts a strain on "Ease of Doing Business".

4.2. Under **section 194J,** any sum by way of **fees for professional services, or fees for technical services**, or any remuneration or fees or commission to a director, or royalty or non-compete fee, is subject to TDS at the rate of 10%. There are certain Court rulings which have dealt with the payment towards certain kind of services (for example - broadcasting and telecasting) which are actually subject to TDS under section 194C as works contract but were recharacterized by the Department as 'fees for technical services' under section 194J read with section 9(1)(vii). In order to reduce the litigation in such matters, it is proposed to reduce the rate of **TDS applicable on FTS (not being a professional service) to 2%** and the other cases remain unchanged at 10%.

IMPACT ANALYSIS

Explanation 2 to section 9(1)(vii) defines FTS to include consideration for rendering of any managerial, technical or consultancy services. In order to settle dispute in case of technical services, the Hon'ble FM should have given instances of such services which could be construed as 'technical' subject to lower rate of TDS. In the absence thereof, a new round of litigation shall open up as to whether or not a particular kind of managerial / consultancy service is in the nature of professional service and therefore, subject to a higher rate of TDS of 10%.

4.3. In cases of assessees being **individual / HUF**, certain TDS provisions viz. sections 194A, 194C, 194H, 194I, 194J and 206C were **applicable only if tax audit was carried out** in the preceding financial year. However, the same is now amended and the applicability of such TDS provisions shall be determined based on the monetary limits of turnover / gross receipts of **Rs 1 crore in case of business and Rs 50 lakhs in case of profession**.

IMPACT ANALYSIS

This would increase the burden of the compliance requirements for the MSMEs having turnover / receipts less than Rs 5 crores whose books are not required to be audited under section 44AB. Further, due to removal of

reference of 44AB, even the assessees opting for presumptive schemes would be required to comply with such withholding tax provisions.

4.4. TDS on payment towards **works contract** is stipulated under section 194C at the rate of 1%/ 2%. The definition of 'work' provided in the Explanation thereto **excludes manufacturing or supplying a product according to the requirement or specification of a customer** by using material purchased from a person, other than such customer. It is now proposed that **in a contract manufacturing**, **the raw material provided** by the assessee or its associate shall fall **within the purview of the 'work' under section 194C**.

4.5. **TDS on E-Commerce Transactions** – It is proposed to introduce TDS by the e-commerce provider (for example Amazon) on the payments to an e-commerce participant (seller of goods / services) at the rate of 1% thereby increasing the compliance burden.

4.6. **Concessional withholding tax rate of 5%** on the interest payments made to non-residents on specified foreign currency borrowings under section 194LC and on the interest payments to Foreign Portfolio Investors ('FPI') on rupee denominated bonds and government securities under section 194LD is extended up to 30 June 2023.

5. Amendments related to Tax Audit, Transfer Pricing Audit and other Reports

5.1. Provisions of tax audit under section **44AB** are currently applicable based on the turnover / gross receipts **threshold of Rs 1 crore** in case of business and Rs 50 lakhs in case of a profession. The threshold for applicability of tax audit is **proposed to be raised to Rs 5 crores** on satisfaction of following conditions:

(a) Aggregate of all the receipts in cash do not exceed **5%** of the total receipts; **and**
(b) Aggregate of all the payments in cash do not exceed **5%** of the total payments;

5.2. Further, the due date for uploading the tax audit report in Form 3CD is modified to be atleast **one month prior to the due date of filing the return of income**. The **due date of filing the return** of income (which is proposed to be pre-filled based on the tax audit report so uploaded) is **extended by one month to 31 October** of the Assessment Year (in cases where transfer pricing provisions are not applicable). Accordingly, in effect, **the tax audit report is required to be uploaded on or before 30 September** of the Assessment Year which is the same as the existing due date. Similar amendment is proposed under section 139 contemplating filing of transfer pricing audit report in **Form 3CEB one month prior to the due date** i.e. in case of transfer pricing cases, due date of filing Form 3CD and Form 3CEB is **preponed to 30th October** of the

Assessment Year. Other reports under section 10, 10A, 115JB, 44DA, 80-IA, etc are also covered under this amendment.

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(a) The increase in the threshold under section 44AB from Rs 1 crore to Rs 5 crores is beneficial to the MSMEs. Assessees not satisfying the cash receipts and payments conditions shall fall under the earlier turnover threshold limit of Rs 1 crore.

(b) There is no amendment in presumptive taxation under section 44AD wherein the turnover / gross receipts threshold for its applicability remains unchanged at Rs 2 crores or below. Also, the clause of getting the books of accounts audited in a scenario where the assessee claims to have earned lower profit than the presumptive rate remains unchanged resulting in multiple thresholds to be checked for the applicability of relevant provisions.

(c) Further, there is no amendment for MSME professionals and therefore, they continue to be subject to the provisions of tax audit if their gross receipts exceed Rs 50 lakhs.

6. Proposals in relation to procedural & administration aspects

6.1. **E-Assessment Scheme** – It is proposed to introduce **faceless appeals** in lines with the faceless assessments and directions in this regard shall be issued by March 2022. Similarly, it is proposed to bring the penalty proceedings under the e-assessment scheme and directions in this regard shall be issued by March 2022.

6.2. Scope of appeals before the **Dispute Resolution Panel** ('DRP') is expanded to include all the issues / additions in case of non-resident assessees and not just limited to transfer pricing issues.

6.3. A **dispute resolution / settlement scheme** – "Vivaad se Vishwas" Scheme is proposed by our Hon'ble FM in the budget speech to **reduce the litigation matters**. Under this scheme, in case of **pending appeals** at any stage, **only the tax amount will have to be paid and it is proposed that there will be a full waiver of interest and penalty**. In case of penalty and interest dispute, which is not related to income, only 25% of such interest and penalty will have to be paid. The scheme is yet to be released in the public domain.

6.4. It is also proposed to amend proviso to section 254(2A) wherein the **ITAT** shall be able to **grant stay** of demand for the **period of 180/365 days**, as the case may be, **only after payment of at least 20% of the demand**. It may result in severe hardship in cases where **high pitched assessments** are made.

7. AMENDMENTS IN INTERNATIONAL TAX PROVISIONS

7.1. **Preamble of Multilateral Instrument ('MLI') to be inserted in section 90** - The provisions of GAAR and the introduction of "Principal purpose test" in MLIs are still in the nascent stage. To add to this, in the context of benefit which can be claimed under the tax treaties over the provisions of the domestic law, it has been proposed that the preamble of MLI be incorporated under section 90(1). It reads as under:

"To eliminate double taxation with respect to the taxes covered by this agreement ***without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance*** *(including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of any other country or territory)."*

7.2. **Modification of income attribution rules** – Currently, the charge of income-tax is **primarily** based on the **territorial source of income**. However, in the advent of the technology driven businesses, there are several instances where the source or nexus may not necessarily be territorial, resulting in base erosion and profit shifting ('BEPS'). **Explanation 3A is added to section 9** defining the income attributable to operations carried out in India to include the following:

– Advertising revenues from ads that target Indian customers or customers who access the advertisement through an Indian IP address
– Income from the sale of data collected from an Indian resident or from anyone through an Indian IP address
– Income from the sale of goods and services using data collected from an Indian resident or from anyone through an Indian IP address.

7.3. **Deferment of Significant Economic Presence ('SEP')** –Finance Act, 2018 inserted a new explanation to Section 9 to clarify that the SEP of a nonresident in India shall constitute "business connection" in India. The provisions are deferred and will now apply from AY 2022-23.

7.4. Exemption from **indirect transfer provisions** contemplated under section 9(1) only to **Category-I FPIs** under the SEBI (FPI) Regulations, 2019 ('new Regulations') instead of earlier exemption granted to Category-I and Category-II FPIs under the erstwhile SEBI Regulations.

7.5. Profit attribution to a Permanent Establishment in India can now be covered under Advance Pricing Agreement and Safe Harbor rules to be notified in this regard.

IMPACT ANALYSIS

(a) Adding preamble of MLI under section 90 could create further confusion regarding the availability of benefit under the DTAA where any country is not a signatory to the MLI or in scenarios where the provisions of MLI is yet to come in effect.

(b) Relaxation from Indirect Transfer provisions to FPIs is only restricted to erstwhile Category-I and Category-II funds and would not be available to erstwhile Category-III funds (which are now Category-II funds under the new regulations).

8. FURTHER IMPETUS TO START-UPS

8.1. In order to further rationalise the provisions relating to start-ups, the Finance Bill 2020 has proposed to amend section 80-IAC of the Act increasing the threshold of total revenue from Rs 25 crores to Rs 100 crores and the period of availability of deduction for 3 years out of total 10 years (earlier 7 years).

8.2. Under the current provisions, ESOPs granted are taxed as perquisite in the year of exercise as contemplated under section 17(2) of the Act. Withholding provisions under section 192 on the perquisite value also triggers upon exercise of the ESOPs by the employee. It is proposed that a startup employer is now required to withhold and deposit tax on perquisite value of ESOP within 14 days of whichever is the earliest:

– expiry of 48 months from the end of the relevant Assessment Year; or
– the date of the sale of such ESOP shares; or
– the date on which the assessee ceases to be an employee.

It may be noted that the aforesaid amendment is proposed only for TDS under section 192 and **no parallel amendment is proposed under the charging provision of section 17(2)** leading to an anomaly which may be rectified at the time of passing the Bill.

9. Other noteworthy amendments

9.1. **Curtailment of benefit for Provident Fund, Superannuation Fund and National Pension Scheme** – Under the current provisions, the employer's contribution to Recognised Provident Fund (RPF) up to 12% of the salary, Superannuation Fund ('SF') up to Rs 150,000 and National Pension Scheme ('NPS') up to 10% of salary is exempt in the hands of the employee. It is now proposed to provide a **combined upper limit** of Rs 7,50,000 in respect of employer's contribution in a year to RPF, SF and NPS, and **any excess contribution** is **proposed to be taxable**. Consequently, it is also proposed that **any annual accretion** by way of **interest, dividend or any other amount of similar nature during the previous**

year to the balance at the credit of the fund or scheme will also be considered under the umbrella of total employer contribution.

9.2. **Penalty for Fake Invoice** – FM stated that after the launch of GST, several cases of fraudulent input tax credit (ITC) claim have been caught by the GST authorities. In order to curb such frauds, it is proposed to introduce **penalty @ 100% of the amount of the fake invoices.** Fake invoices / false entries are separately defined in proposed new section 271AAD.

9.3. **Increasing safe harbor limits for immovable property related transactions** - Under the current provisions, in case of transactions in immovable property executed below the stamp duty value, the stamp duty value is to be considered as the full value of consideration if the deviation is in excess by 105%. It is, now proposed to increase the current safe harbor from 5% of the stamp duty value of the capital asset to 10%.

9.4. **Insertion of Taxpayer's Charter in the Act** – In the budget speech, FM mentioned placing emphasis on protecting the taxpayers from the harassment of the tax officials. Section 119A is proposed to be inserted in the Act to empower the CBDT to adopt and declare a Taxpayer's Charter and issue such orders, instructions, directions or guidelines to other income-tax authorities as it may deem fit for the administration of Charter.

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