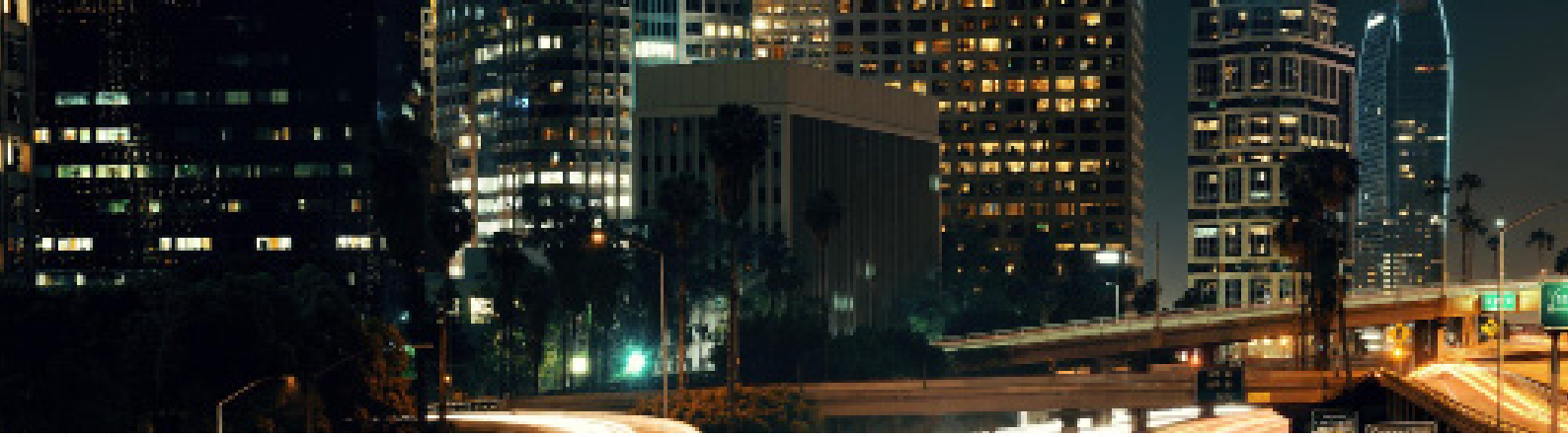
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ERGO

BUDGET 2024 | DIRECT TAX PROPOSALS





RATES FOR CORPORATES AND FIRMS

The Finance (No. 2) Bill, 2024 (Bill) does not propose any change in the tax rates for domestic companies and firms under the Income-tax Act, 1961 (IT Act). The base tax rates are listed below for ready reference:

- **Domestic companies:** 15% / 22% / 25% / 30%, depending on factors such as nature of business, commencement of operations, turnover thresholds, optional concessional tax regime, etc
- **Partnerships and LLPs:** 30%

Surcharge on base rates, too, remain unchanged for these entities.

Reduction in tax rate for foreign companies

The Bill proposes to reduce the base corporate tax rate from 40% to 35% (special rates for specified income streams such as interest, fees for technical services, capital gains, and dividends in specified circumstances shall continue to apply). There has been no change proposed in the surcharge rates.

Further, there has been a substantial overhaul in the capital gains tax regime (tax rates, period of holding, indexation, etc.) for all taxpayers (residents and non-resident); these are separately discussed in subsequent sections of this Ergo.

OVERHAUL OF CAPITAL GAINS TAX REGIME

In order to simplify and rationalize the capital gains tax regime, the Bill proposes to amend (with effect from 23 July 2024) the holding period as well as tax rates as set out below:



Capital asset	Nature of capital gains	Tax rate	
		Current	Proposed
Listed equity shares and units of equity-oriented fund	Long Term	10% on gains exceeding INR 0.1 million[1]	12.5% on gains exceeding INR 0.125 million
	Short Term	15%	20%
Listed units of ReIT / InvIT	Long Term[2]	10%	12.5%
	Short Term	15%	20%
Other listed securities	Long Term	• Indian resident: 20% (with indexation) / 10% (without indexation); • Non-resident: 10%	12.5%
	Short Term	Applicable rate	Unchanged
Other assets (such as immovable property, gold, etc)	Long Term[3]	20%	12.5%
	Short Term	Applicable rate	Unchanged

[1]Resident investors selling listed equity shares off-market shall be taxed at 20% (with indexation) or at 10% (without indexation)
[2]Holding period for units of ReIT /InvIT to qualify as long-term capital asset proposed to be reduced from 36 months to 12 months
[3]Holding period for other assets (other than slump sale transactions) to qualify as long-term capital asset proposed to be reduced from 36 months to 24 months



Indexation benefit no longer available

With the rationalisation of the long-term capital gains tax rate to 12.5%, the benefit of indexation is proposed to be removed for calculation of any long-term capital gains which is currently available for long-term capital assets (such as unlisted securities for resident investors, immovable property and gold).

The overhaul aims to significantly streamline the capital gains provisions across investor class and asset class. From the perspective of cost adjustment on long term assets such as immoveable property, the abolishment of indexation of cost could potentially result in higher capital gains outflow (depending on factors such as original cost of acquisition and holding period).

This amendment is proposed to be effective from 23 July 2024.

Taxation of debt instruments

- **Specified Mutual Fund | Clearing the Greys**

Section 50AA of the IT Act deems income arising on transfer or redemption or maturity of units of 'Specified Mutual Fund' as short-term capital gains. 'Specified Mutual Fund' is defined to mean any mutual fund, where not more than 35% of its total proceeds is invested in the equity shares of domestic companies. This created an ambiguity on applicability of Section 50AA to other non-debt funds as well as fund of funds. The Bill proposes to amend the definition of 'Specified Mutual Fund' to mean (i) mutual fund which invests more than 65% of its total proceeds in debt and money market instruments, and (ii) a fund which invests 65% of its total proceeds in the foregoing mutual fund. It is also proposed that the debt and money market instruments shall include securities classified or regulated by Securities and Exchange Board of India, which indicates that applicability of Section 50AA should be limited to India focused funds.

This amendment is proposed to be effective for FY 2025-26 and onwards.

- **Unlisted Bonds and Debentures | Short Term Capital Gains**

Noting that unlisted bonds and debentures are debt instruments, the Bill proposes to include unlisted bonds and debentures within the ambit of Section 50AA and tax the income arising on transfer or redemption thereof as short-term capital gains regardless of the period of holding. Having said that, foreign investors may assess to claim the benefit (if any) on such capital gains under an applicable tax treaty.

This amendment is proposed to be effective from 23 July 2024.

Capital gains exemption on gifts, restricted to individuals/HUFs

Currently, transfer of capital asset under a gift, will, irrevocable trust is exempt from capital gains tax – notably, this exemption provision is not confined to any specific class of donors. Accordingly, corporate taxpayers also claimed this capital gains tax exemption on the ground that the condition of natural love or affection is not a prerequisite to qualify as a gift.

The Bill proposes to clarify that this capital gains tax exemption would only apply if the donor is an individual or a HUF.

This amendment is proposed to be effective for FY 2024-25 and onwards.



ABOLITION OF ANGEL TAX AND BUYBACK TAX

Angel tax no more - Bill spreads wings for startups and investors alike

Currently, at the time of issuance of shares by a closely held company, any consideration received in excess of the fair market value of such shares (determined as per prescribed rules), is taxed as ordinary income of issuing company. This provision is widely referred to as 'angel tax'. This tax applies to shares issued to resident as well as non-resident investors (the scope was widened to cover non-resident investors from 1 April 2023), with certain specified exemptions (such as issue of shares by recognized start-ups). Several companies, especially startups, have faced significant litigation on this issue. In this backdrop, even the Department for Promotion of Industry and Internal Trade had recommended scrapping angel tax for all startups.

In a welcome move, the Bill proposes to abolish angel tax altogether for FY 2024-25 and onwards.

Notably from a Section 68 perspective which seeks to tax (albeit at a higher rate) inter alia the company on receipt of share capital, share premium in certain scenarios, the requirement to demonstrate the identity, genuineness and creditworthiness of the investors (other than VCFs) will continue to be relevant.

Reinstatement of shareholder level tax on buyback

Currently, buyback of shares is taxed in the hands of the company undertaking the buyback and the shareholder is exempt from tax. The Bill proposes to reinstate the regime of taxing the shareholder for buyback undertaken on or after 1 October 2024; we have summarised the current regime and the proposed regime in the table below:

Taxpayer	Current Regime	Proposed Regime
Company undertaking buyback	Taxed at 23.3% on the difference between the buyback proceeds and issuance price.	No tax
Shareholder	No tax	• Tax on the buyback proceeds as 'dividend' income (without any deduction) • Cost of shares shall be treated as capital loss which would be eligible for set-off as per extant law

Notably, in the proposed regime, the dividend characterisation for the shareholder is irrespective of whether the company has any accumulated profits. From a compliance standpoint, companies undertaking buyback would need to withhold applicable tax on payments to resident and non-resident shareholders (subject to tax treaty relief, if any).



2% DIGITAL TAX ABOLISHED!

Equalisation Levy (EL), introduced in 2016 at a rate of 6% (six percent), was initially aimed at taxing non-residents on provision of online advertising and related services to Indian residents or non-residents with a permanent establishment in India. The scope of EL was enlarged in 2020 to provide for a 2% (two percent) levy on e-commerce supply of goods and services by non-residents to Indian residents / non-residents (in certain specified circumstances). The provisions are wide and could include a variety of businesses engaged in supply or services, or facilitation thereof, through a digital platform or a facility.

Notably, EL is levied under a separate code and not the IT Act and, therefore, is not subject to the beneficial tax treaty provisions, if any. Availability of credit of EL paid in India against the tax liability of non-residents in their home jurisdiction is also doubtful and could therefore be an additional cost of doing business in India.

In a relief to global businesses engaged in supply or services (or facilitation thereof) through digital means, the Bill proposes withdrawal of the 2% (two percent) EL with effect from 1 August 2024.

This proposal will do away with any India tax obligations and compliances for these businesses. Needless to say, the taxability of any income earned by such businesses from India would be tested under the general provisions of the IT Act read with the applicable tax treaty.

This move underscores India's commitment to the proposed two pillar reforms aimed at addressing challenges arising from an increasingly digitalized economy and follows global consensus instead of unilateral measures under domestic laws.

YET ANOTHER GIFT!

In an endeavour to promote the International Financial Services Centre (IFSC) in GIFT City, the Government has introduced various tax and regulatory incentives over a period of time and has kept up the tradition by announcing another round of perks in this Bill (proposed to be effective for FY 2024-25 and onwards), as set out below:

Widening the scope of 'Specified Funds'

Currently, Section 10(4D) of the IT Act provides that 'specified funds' are, inter alia, exempt from tax on income from transfer of specified assets listed on recognised stock exchange in IFSC as well as on income from transfer of securities (other than shares in an Indian company). Additionally, 'specified funds' are eligible to be taxed at the concessional rate of 10% on dividend and interest on securities. The ambit of 'specified funds' which can claim this exemption is proposed to be expanded to include (i) funds set up in IFSC as a retail scheme, and (ii) an Exchange Traded Fund (ETF), which are regulated under the International Financial Services Centres Authority (Fund Management) Regulations, 2022 (IFSCA Regulations).

Relief for investments received from Venture Capital Funds (VCFs) in IFSC

Section 68 of the IT Act requires taxpayers to explain the 'source of source' of funds credited in their books (as share capital, loans, etc.) and, failing which such credits could be deemed as income of such taxpayers, taxable at double the tax rate applicable ordinarily (i.e., 60%). However, an exemption is available from explaining the 'source of source' of funds in relation to the amounts received from VCFs as defined under Section 10(23FB) of the IT Act.



The Bill proposes to amend the definition of VCFs to include venture capital schemes in IFSC registered under IFSCA Regulations.

Finance companies in IFSC exempted from thin capitalisation provisions

Section 94B of the IT Act restricts tax deduction of interest expense in respect of any debt extended by a non-resident associated enterprise, to 30% of the earnings before interest, taxes, depreciation, and amortisation of the Indian borrower company. However, this limitation does not apply to an Indian company or a permanent establishment of a foreign company engaged in banking or insurance business as well as notified non-banking financial companies. The Bill proposes to extend this exemption to finance companies set up in IFSC.

TAX DEDUCTION AT SOURCE (TDS) RELATED PROPOSALS

Rationalisation of TDS rates

The Bill proposes to rationalise the TDS rates for certain specified payments, including reduction in TDS rate (from 1% to 0.1%) on payment of sums by e-commerce operator to e-commerce participant. Further, the Bill proposes to remove the TDS obligation (currently, 20%) on repurchase of units of mutual funds or the Unit Trust of India.

New limitation periods for tax withholding and collection proceedings regardless of residency of payee and payor

Currently, non-compliance with tax withholding and collection requirements renders a person an 'assessee-in-default' attracting consequential interest and penalties. For payments to residents, the IT Act stipulates a limitation period of 7 (seven) years from the end of the relevant FY or 2 (two) years from the end of the FY of filing revised TDS returns by the payor, whichever is later, for deeming a person as an 'assessee-in-default'. However, for payments to non-residents, the IT Act does not specify any limitation period, leading to ambiguity. Since the law is silent, the courts have in some cases ruled on what should be the applicable limitation period in light of the facts and circumstances of each case and hence, the determination is largely subjective.

Similarly, the IT Act lacks a specific limitation period for deeming a person as an 'assessee-in-default' in cases of tax collection at source from both resident and non-resident payors.

In a move to objectively define and align the limitation period for proceedings relating to tax withholding and collection requirements with respect to payments to and receipts from residents as well as non-residents, the limitation period is proposed to be standardized to 6 (six) years from the end of the relevant FY or 2 (two) years from the end of the FY of filing revised TDS/ TCS returns, whichever is later. Standardisation of the limitation period is a testament to the Government's commitment to fostering a more predictable tax environment for all stakeholders, and reduced litigation.



SETTLE YOUR CASES - VIVAD SE VISHWAS SCHEME, 2024

Currently, there is high pendency of tax cases before various appellate fora. The Government had earlier launched a Vivad se Vishwas Scheme (VsV Scheme) in the year 2020 for settlement of tax disputes, which received a good response from taxpayers. Aside from settling longstanding tax disputes, the Government was able to recover substantial revenues from such settlements as well.

The Bill proposes to re-introduce the tax disputes settlement scheme (Direct Tax Vivas se Vishwas Scheme, 2024), with the effective date of the scheme along with other finer details to be notified separately.

As per the proposed scheme, taxpayers whose appeal is pending before any fora (be it Supreme Court, High Courts, Income Tax Appellate Tribunal (ITAT), Commissioner of Income Tax (Appeals) (CIT(A)), Joint Commissioner of Income Tax (Appeals) (JCIT(A)), or Dispute Resolution Panel (DRP)) as on the specified date (to be notified), will be eligible to settle the dispute by paying the following amounts:

Nature of Dispute	Amount payable under this Scheme on or before 31 December 2024	Amount payable under this Scheme on or after 1 January 2025 but before the 'last date'
Dispute concerns tax, interest and penalty and the appeal has been filed after 31 January 2020	100% of disputed principal tax	110% of disputed principal tax
Dispute concerns tax, interest and penalty and the appeal is pending (at the same forum) since 31 January 2020	110% of disputed principal tax	120% of disputed principal tax
Matter concerns disputed interest, penalty or fee and the appeal has been filed after 31 January 2020	25% of such disputed interest, penalty or fee	30% of such disputed interest, penalty or fee
Matter concerns disputed interest, penalty or fee and appeal is pending (at the same forum) since 31 January 2020	30% of disputed interest, penalty or fee	35% of disputed interest, penalty or fee

Further relaxation in some cases

The fees prescribed in the aforesaid table would be reduced by 50% in the following circumstances:

- An authority under the IT Act is in appeal and the taxpayer wishes to settle such an appeal.
- An appeal is pending before the JCIT(A), CIT(A), DRP on any issue on which the taxpayer had received a favourable decision of ITAT (not reversed by High Court or Supreme Court) or favourable decision of High Court (not reversed by Supreme Court).
- An appeal is pending before ITAT on any issue on which the taxpayer has received a favourable decision of High Court (not reversed by Supreme Court).



LITIGATION, PENALTY, AND PROSECUTION

Reassessment timeline truncated

Under the current reassessment regime, a notice under Section 148A of the IT Act is required to be provided to the taxpayer for providing an opportunity to be heard prior to issuing a reassessment notice under Section 148 of the IT Act.

The maximum time period for re-opening tax assessments has been decreased to 6 years and 3 months from the end of the relevant FY to which the concerned income pertains (as opposed to the current timeline of 11 years from the end of the relevant FY).

The amendments are proposed to be effective from 1 September 2024.

These amendments are a welcome move which will result in bringing tax certainty and end long drawn proceedings for old assessment years.

Relaxation from prosecution proceedings for delay in deposit of TDS

Under the current reassessment regime, a notice under Section 148A of the IT Act is required to be provided to the Section 276B of the IT Act provides for prosecution in case of failure (within the prescribed timelines) to deposit taxes withheld to the credit of the Central Government.

The Bill proposes to decriminalise non-deposit of TDS if TDS in respect of a quarter is deposited with the Central Government at any time on or before the prescribed time for filing the statement of TDS for the respective quarter.

This amendment is proposed to be effective from 1 October 2024.



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