KATALYST
ADVISORS LLP

Katalyst Kaleidoscope

February 2021: The Union Budget 2021-22

OUR ANALYSIS ON UNION BUDGET 2021 – 2022

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A. Background and Macro factors

Introduction

The Budget proposals for 2021-2022 were divided into 6 categories, broad initiatives of which have been summarised below:

i. Health and Wellbeing
   - PM Aatmanirbhar Swasth Bharat Yojana and Mission Poshan 2.0 have been launched.
   - INR 35,000 crores is proposed to be allocated for COVID-19 vaccines, and expansion of the health information portal to connect all public health labs across all states and union territories is proposed.

ii. Physical & Financial Capital, and Infrastructure
   - INR 1.97 lakh crores will be allocated to the Production Linked Incentive schemes for 13 sectors which include pharmaceutical drugs, solar PV modules, automobiles and automobile components, etc.
   - Other impetus to infrastructure sector includes introduction of Development Financial Institution (discussed in detail in Part B) and monetizing operating public infrastructure assets for funding infrastructure.

iii. Inclusive Development for Aspirational India
   - Agriculture and allied activities have been focused on by increase in allocations to the Rural Infrastructure Development Fund and Micro Irrigation Fund, among others.

iv. Reinvigorating Human Capital
   - Thrust on higher education and upskilling of local talent by allocating funds to National Apprenticeship Training Scheme and initiating cross-country workforce training programmes with several other countries.

v. Innovation and R&D
   - INR 1,500 crores will be allocated for a proposed scheme that will provide financial incentive to promote digital modes of payment.
   - Also, an outlay of INR 500 billion on the National Research Foundation is proposed over a period of 5 years to strengthen research ecosystem.

vi. Minimum Government and Maximum Governance

- Conciliation Mechanism is proposed to be set up for resolution of contractual disputes in dealings with the Government and Central Public Sector Companies.

The impact of the pandemic on the economy at the beginning of the current financial year has resulted in weak inflows combined with high expenditure.

- Fiscal deficit for FY21 as per the revised estimates is 9.5% of GDP and is budgeted to be at 6.8% of GDP for FY22. Net tax revenues for FY22 are expected to grow at ~14% (as against the revised estimates of FY21), equivalent to the budgeted GDP growth.

- Significant increase in capital receipts in FY22 will be on account of budgeted disinvestment proceeds of INR 1,75,000 crores, expected to be raised on account of the initial public offering of Life Insurance Corporation and the proposed privatization of IDBI Bank, 2 public sector banks, and 1 general insurance company as well as of Air India, BPCL, Shipping Corporation, Pawan Hans, etc. The balance fiscal deficit (to the extent of ~INR 15 lakh crores) is proposed to be financed through borrowings raised through government securities and treasury bills and in the form of external debt and securities from small savings.

Budget 2021 at a glance:

Budget at a Glance			
			(Rs. in lakh crores)
	2019-20	2020-21	2021-22
	Actuals	Revised Estimates	Budget Estimates
Net Tax Revenues	13.57	13.45	15.45
Non Tax Revenues	3.27	2.11	2.43
Total Revenue Receipts (A)	**16.84**	**15.55**	**17.88**
Non Debt Capital Receipts (B)	0.69	0.46	1.88
Total Revenues (C = A + B)	**17.53**	**16.02**	**19.76**
Revenue Expenditure (D)	23.51	30.11	29.29
Capital Expenditure (E)	3.36	4.39	5.54
Gross Domestic Product (GDP)	203.51	194.82	222.87
Revenue Deficit (A - D)	**6.67**	**14.56**	**11.41**
% of GDP	*(3.3)*	*(7.5)*	*(5.1)*
Fiscal Deficit (C - D - E)	**9.34**	**18.49**	**15.07**
% of GDP	*(4.6)*	*(9.5)*	*(6.8)*

B. Certain key policy announcements

1. Enabling foreign investment in insurance sector

- One of the key areas of foreign investment which is being opened up for foreign investors is the insurance sector. Earlier, the government had increased investment by a foreign investor from 26% to 49% under the FDI regime, under automatic route (i.e. without prior approval of the government). In the present Budget, the Hon'ble Finance Minister in her budget speech has stated that the foreign investment, under the FDI route and without prior government control, in the insurance sector would be permitted upto 74%. Insurance is a capital-intensive business and this is a welcome move.

Katalyst Comments:

- *The earlier intent was to have the insurance companies as Indian-owned and controlled entities. This created restrictions and limitations from the perspective of raising capital to maintain solvency, exit for Indian promoters, entry of foreign strategic and financial investors, etc.*

- *In order to address the above, the present policy initiative is laudable. However, only time will tell whether this move will actually attract investors since it was also mentioned in the budget speech that this new structure will have certain safeguards (or rather restrictive conditions), viz., that the majority of Directors on the Board and key management persons shall be resident Indians, with at least 50% of Directors being Independent Directors, and specified percentage of profits being retained as general reserve.*

2. Consolidation of Securities' Laws into a Single Code and Impetus to Financial Capital

- It was announced that the a single, consolidated, Securities' Market Code would be introduced, thereby, consolidating the discrete laws in the form of SEBI Act, 1992, the Depositories Act, 1996, Securities Contracts (Regulation) Act, 1956 and the Government Securities Act, 2007.

- Further, in order to strengthen the corporate bond markets, it was also proposed to create a permanent institutional framework, which should mobilize capital raising through corporate bonds as well as help the retail investors participate directly in such corporate bond issuance, while protecting their interest.

Katalyst Comments:

- *As is the case with consolidation of different laws, the compliance costs should reduce and the interpretational gaps between different securities' laws while interpreting the provisions of various laws would also be reduced as a result of a single Securities' Market Code.*

- *However, the manner of transition and streamlining various regulations already enacted by various regulators would need to be seen once the Code is consolidated.*

3. **Introduction of Bad Bank in the form of Asset Reconstruction Company and Asset Management Company ("ARC" and "AMC")**

- It is proposed that an ARC and AMC would be set up to takeover the stressed assets of public sector banks, and thereafter, managing and disposing it off to Alternative Investment Funds and other potential investors for value realization.

Katalyst Comments:

This policy initiative, if implemented, would pave road for establishing, effectively, a "bad bank". Therefore, this will help achieve the following trinity:

- *Facilitate cleaning up of books of public sector banks, which are marred by high provisioning for stressed assets;*
- *Provide capital relief and help to re-balance capital adequacy ratios for the banks; and*
- *Attract investors and unlock valuation, especially if the stressed assets with different credit profiles so taken over, are sliced and diced into securitization papers, thereby, diversifying credit risk for the investors.*

4. **Matters in relation to the Company Law**

- **Decriminilization of the LLP Act, 2008 –** Proposal to take up decriminalization under various provisions of the LLP Act, 2008 would be taken up (akin to what was taken up under the Companies Act, 2013)

- **Widening the ambit of Small Companies –** Under the Companies Act, 2013, small companies are such companies whose paid up capital does not exceed INR 50 Lacs and whose turnover does not exceed INR 2 Cr. For such companies, there are various relaxations under the Companies Act, 2013 such as lower filing and RoC fees, lower penalties, exemption from preparing cash flow statements, fast-track merger process, (i.e. without NCLT approval) etc. It was proposed that the definition of small companies would be widened so as to include companies which have a paid-up capital of less than INR 2 Cr and turnover of less than INR 20 Cr. This move is stated to reduce compliance burden of over 200,000 companies.

- **Incentivizing One Person Companies –** It was proposed to incentivize the incorporation of One Person Companies ("OPCs") by allowing OPCs to grow without any restrictions on paid up capital and turnover, allowing their conversion into any other type of company at any time, reducing the residency limit for an Indian citizen t set up an OPC from 182 days to 120 days and also allow Non-Resident Indians (NRIs) to incorporate OPCs in India.

- **Strengthening the NCLT Regime:** To ensure faster resolution of cases, the NCLT framework will be strengthened and e-Courts system will be implemented. Further, and alternate methods of debt resolution and special framework for MSMEs will also be introduced.

Katalyst Comments:

This policy initiative should help streamline various cases under the Companies Act, 2013 such as implementation of Scheme of Arrangement u/s 230-232 of the Companies Act, 2013, resolution of IBC cases, addressing cases concerning prevention of oppression and mismanagement, etc.

5. **Impetus to Infrastructure Financing**

- It was proposed that a Development Financial Institution ("DFI") will be set up which will be a professionally managed institution to act as a provider, enabler and catalyst for infrastructure financing.

- Further, debt financing of InVITs and REITs by Foreign Portfolio Investors will be enabled by making suitable amendments in the relevant legislations. This will further ease access of finance to InVITS and REITs, thus augmenting funds for infrastructure and real estate sectors

Katalyst Comments:

The concept of a professionally managed financing institution is not a new one. IL&FS could be considered as a predecessor to the proposed DFI. However, the lack of internal checks and balances led to mismanagement of IL&FS, ultimately leading to the failure of achieving the objectives as envisaged at the time of set up of IL&FS.

6. **Other Policy Initiatives**

- Announcement of a Conciliation Mechanism to have ease of doing business and enable quick resolution of contractual disputes, for those who deal with Government or CPSEs, and carry out contracts

- Introduction of investment charter as a right of all financial investors across all financial products

- Transfer of road assets and transmission assets of NHAI and PowerGrid Corporation of India Limited to InvIT

- Debt recovery under SARFAESI reduced from INR 50 Lacs to INR 20 Lacs to protect the interest of small borrowers for NBFCs with minimum asset size of INR 100 crores

C. Key Direct Tax Proposals

Amendments in relation to Business Restructuring

1. Amendment in the definition of the term "slump sale"

- "Slump Sale", as defined u/s 2(42C) of the ITA, means transfer of one or more undertakings "***as a result of the sale***" for a lump sum consideration without values being assigned to the individual assets and liabilities in such transfer.

- Accordingly, earlier, only transactions for which the consideration was either in the form of money or in the form of a deferred yet pre-determined consideration or in the form of issuance of a debt instrument (again with a pre-determined liability) was considered as a "sale" of an undertaking. Consequently, where the transfer of an undertaking was for a consideration other than the above mentioned forms (say, in the form of issue of fresh equity shares), typically, known as "slump exchange", was not considered as a "slump sale".

- Therefore, since there was no specific mechanism to compute capital gains tax for a "slump exchange", it was held by various authorities in the past (most notably, by the Bombay High Court in the case of **Bharat Bijlee Ltd[1]),** that such a transfer pursuant to "slump exchange" would not be subject to capital gains tax.

- The Finance Bill 2021 has now proposed to widen the scope of "slump sale" so as to mean transfer of one or more undertakings, ***by any means***, for lump sum consideration without any value being assigned to individual assets and liabilities. Consequently, all types of "transfer" as defined in clause (47) of section 2 of the ITA to include within its scope. As a result, any transfer of undertaking pursuant to an exchange, as well, would be included in the definition of "slump sale".

Katalyst Comments:

The above amendment has widened the scope of slump sale transactions so as to include non-monetary consideration/ exchange transactions within its purview. Therefore, the provisions of section 50B of the ITA would apply, mutatis mutandis, to transfers pursuant to slump exchange as well where the consideration could be in the form of fresh issue of equity shares.

Further, it is imperative to note that if fresh equity shares are issued, then the true fair market value of shares issued shall be deemed as a consideration u/s 50D of the ITA. There could be arbitrariness while computing the FMV of such shares given that there is no specified methodology to determine fair market value of shares u/s 50D of the ITA.

[1] CIT vs. Bharat Bijlee Ltd [2014] 46 taxmann.com 257 (Bombay)

2. Depreciation on Goodwill

2.1. Exclusion of Goodwill from the concept of "Block of Assets"

- The extant provisions of section 32 of the ITA provide for depreciation on tangible as well as intangible assets used for business or profession. Intangible assets included know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature. However, goodwill of a business or profession, was not specifically included in the definition of intangible assets.

- Pursuant to prolonged litigation on the issue of whether goodwill, arising from acquisition of a business either through slump sale or amalgamation or demerger or any other mode, should be considered as an intangible asset and eligible for depreciation, the Apex Court concluded favourably in the case of Smiff Securities Limited[2] and held, reasonably so, that goodwill of a business or profession is a depreciable asset under section 32 of the ITA.

- **Proposed Amendment:** It is now proposed to amend section 2(11) of the ITA which defines block of assets and section 32 of the ITA to categorically provide that goodwill should neither be included in "block of asset" nor should it be considered as an asset for the purposes of section 32 of the ITA. The overall impact of the above would be that such goodwill would not be eligible for depreciation. This amendment shall be effective from AY 2021-22 (i.e. this financial year itself)

Katalyst Comments:

Effectively, the proposed amendments would nullify the judgment of the Supreme Court (supra) and various other subsequent judgments. Consequently, the sound principles of commercial prudence evolved in the past, and especially over the last nine years, in relation to depreciation on goodwill, specifically in cases of acquisition of business between third parties, and the valuation of which is at arms' length, would be overruled by this amendment.

The axiom of "intended consequences" would squarely apply here since the benefit of tax break available to the acquirer on account of depreciation on goodwill would now not be available and therefore, result in lower negotiating power to the seller while valuing the business.

Further, it is imperative to note that, effectively, the above amendments are retroactive in nature since depreciation on any past goodwill, although claimed in the past, would

[2] (2012) 348 ITR 302 (SC)

not be available going forward. Therefore, while the amendment is prospective, it would adversely impact any goodwill created prior to 31 March 2021 as well.

Lastly, it is pertinent to note that the proposed amendment only excludes "goodwill" from the definition of "block of assets" and not any other intangible assets.

2.2. Consequential Amendments

- Consequently, section 50(2) of the ITA is proposed to be amended to prescribe a manner for determining tax WDV and short term capital gains, if any, upon cessation of the block of asset, where the goodwill formed part of the said block as on 1 April 2020 and depreciation was claimed thereon.

- Since the goodwill will continue to be considered as a capital asset (albeit not depreciable), the cost of acquisition for the goodwill would be determined as per section 55(2)(a) of the ITA. The said section is proposed to be amended to provide the following:

    i. where goodwill (or trademark, brand, right to manufacture, etc.) has been acquired by way of purchase, the cost thereof should be the purchase price paid (adjusted for the depreciation claimed upto 31 March 2020);

    ii. where the goodwill has been acquired by way of transactions covered under section 49(1) of the ITA (gift, distribution upon dissolution of firm, distribution upon liquidation of company, amalgamation, etc.), the cost should be the purchase price paid by the previous owner (adjusted for the depreciation claimed upto 31 March 2020); and

    iii. in all other cases, cost should be nil.

Katalyst Comments:

Given that goodwill would be excluded from the definition of "block of assets", the block of assets, as regards "goodwill", would cease to exist. Therefore, presumably, such cessation should not be subject to capital gains tax and would be clarified by the CBDT in due course.

Further, by virtue of the amendment to section 55(2)(a) of the ITA, any goodwill being generated by way of amalgamation or demerger or slump sale or any other mode, shall continue to be a capital asset but not be eligible to depreciation. Therefore, such goodwill should be available as a part of cost of acquisition on subsequent slump sale, if any of such asset.

3. Capital Gains Taxation at the time of Dissolution or Reconstitution of a Partnership Firm/ LLP / AOP/ BOI[3]

- Presently, section 45(4) of the ITA stipulates that any distribution of capital assets at the time of dissolution or reconstitution of a partnership firm/ LLP/ AOP/ BOI ("Specified Entity") to a partner of a partnership firm or member of AOP/ BOI ("Specified Person") is subject to capital gains tax in the hands of such Specified Entity. Further, fair market value ("FMV") of such capital asset so distributed is deemed as consideration in the hands of the Specified Entity, while computing capital gains tax in the hands of such Specified Entity. (N.B.: Cost of Acquisition of such capital asset so distributed is available as a deduction from the FMV of such capital asset while computing capital gains tax).

- However, there were cases where, instead of a capital asset, money or any other asset (other than capital asset) was distributed to the Specified Person at time of dissolution or reconstitution of the Specified Entity. Further, in various cases such money/ any other assets so distributed was in excess of the credit balance of capital account of such Specified Person. Various judicial precedents have held that the provisions of section 45(4) of the ITA were not applicable if the asset so distributed was not a capital asset.

- Further, it was also held in various cases that, if the Specified Person's capital account had been revalued prior to distribution of money/ other assets, then such distribution was not taxable in the hands the recipient of such money/ other assets (i.e. the Specified Person).

- **Proposed Amendment:** In order to address the above, the Finance Bill, 2021 has sought to substitute section 45(4) of the ITA and insert a new section 45(4A) in the ITA to provide as follows:

  a. For Distribution of Capital Asset (Amended Section 45(4) of the ITA)
  - Any receipt of capital asset, representing the balance in the capital account of a Specified Person, by a Specified Person shall be taxable in the hands of the Specified Entity (and not the Specified Person) as capital gains on the difference between the FMV of such capital asset and the cost of acquisition.

  b. For Distribution of Money or Any Other Assets (New Section 45(4A) of the ITA)
  - Any receipt of money or any other asset by a Specified Person shall be taxable in the hands of the Specified Entity (and not the Specified Person) as capital gains, provided such money or value of other asset is in excess of such Specified Person's capital account (ignoring any self-generated goodwill)

Katalyst Comments:

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[3] LLP - Limited Liability Partnership
AOP – Association of Persons
BOI – Body of Individuals

The above amendments seek to provide clarity on the capital gains taxation at the time of not only dissolution but also reconstitution (say, in case of retirement, adjustment of profit-sharing ratio without any retirement, etc.); albeit there should not be any trigger sans any reconstitution or dissolution.

However, it is also imperative to note that the ratio of certain judicial precedents (most notably, the decision of the Supreme Court in the case of Mohanbhai Pamabhai[4]) should continue to apply in cases where the amounts so distributed (other than capital assets) are not in excess of partners' capital account.

Amendments relevant to Non-Resident Indians

4. Insertion of definition of term "liable to tax"

- Last year, the Finance Act 2020 amended section 6 to insert a new clause (1A) with an intention to tax citizens of India, having Indian-sourced income exceeding INR 15 lakhs during a financial year to be deemed to be a resident in India for that year, if he is not ***"liable to tax"*** in any other country or territory by reason of his domicile or residence. However, the phrase "liable to tax" was not defined and therefore, had created certain interpretational issues.

- The Finance Bill 2021 has now proposed to insert a new clause (29A) to section 2 of the ITA to provide for the definition of the term "liable to tax" in relation to a person to provide as under:

  a. There is a liability of tax on such person under any law for the time being in force in any country, and

  b. It shall include a case where subsequent to imposition of tax liability, an exemption has been provided.

Katalyst Comments:

The interpretation of the phrase "liable to tax" was a matter of concern, since there was no clarity in cases where there was no income-tax leviable at all, in the first place. For example, in jurisdictions such as the UAE, there is no personal tax leviable on a person, while the jurisdiction retains the power to tax any person at any point in time. Therefore, whether such person would be considered as "liable to tax" in such jurisdiction was unclear.

Now, with this amendment, it is sought to be clarified that in cases where a person can merely be subjected to tax in the future, but no liability is imposed at present, would not be considered as a person "liable to tax" for the purposes of deemed residency u/s 6(1A) of the ITA.

[4] [1987] 165 ITR 166 (SC)

5. Relief from taxation in income from notified overseas retirement fund

- At present, there may be a mismatch in the year of taxability of withdrawal from retirement funds in the hands of residents who had opened such funds when they were non-resident in India and resident of the foreign country. The withdrawals from such funds would have been taxed on receipt basis in such foreign countries, while such funds would be taxed on accrual basis in India, if such a person were to become a resident of India.

- In order to address this mismatch, the Finance Bill 2021 proposes to insert a new section 89A to the ITA, to provide that the income of a "specified person" (i.e. a person resident in India) who opened "specified account" (i.e. retirement fund account) while he was an NRI, shall be taxed in the manner and in the year as prescribed by the Central Government.

Katalyst Comments:

This is a limited relief extended to returning non-residents back to India after retirement, by providing a mechanism to avoid double taxation on withdrawal of retirement funds, which would otherwise have been taxable both on receipt basis in the foreign country and on accrual basis in India.

<u>Amendments relevant to foreign investors</u>

6. Tax deducted at source ("TDS") Provisions u/s 196D in relation to Foreign Portfolio Investors ("FPI")

- Presently, section 196D of the ITA stipulates that any income from securities (other than interest on Rupee-Denominated Bonds earned till 1 July 2023 and other than capital gains) such as dividend income or interest income earned by an FPI shall be subject to a withholding tax of 20%. However, the final tax liability of such FPI may be lower, if the tax rates under country-specific Double Taxation Avoidance Agreements ("DTAA") is lower than 20%.

- Therefore, there was an uncertainty as to whether the lower tax rates prescribed in the relevant DTAAs could also extend to the withholding tax provisions u/s 196D of the ITA. Recently, the Supreme Court in the case of PILCOM v. CIT West Bengal had held that the benefit of lower tax rates in the relevant DTAAs shall also extend to withholding taxes.

B. In the context of the above, a proviso to section 196D of the ITA is proposed to be inserted whereby the benefit of lower withholding taxes should be available to FPIs, provided such FPIs provide a valid Tax Residency Certificate.

Katalyst Comments:

Certain Tax Treaties provide for a lower tax rate for dividend/ interest income for FPIs such as:

- *Generally, 15% (for dividend income) or 7.5% (for interest income) in case of India-Mauritius Tax Treaty*
- *10% (for dividend income) or 12.5% (for interest income) in case of India-UAE Tax Treaty*
- *Generally, 15% (for dividend income or interest income) in case of India-Singapore Tax Treaty*

Therefore, both for dividend income and interest income, there was a cash flow issue for the income earned by the FPIs since the withholding taxes could have been at a higher rate of 20%, while the final tax liability could be lower than that, if the benefit under the respective DTAA were to be claimed, and the FPIs would have had to file a tax return to claim such tax refund. Therefore, this amendment would resolve the timing issue by enabling a lower withholding tax rates, if the respective DTAAs provide for a lower tax rate.

7. Provisions related to Sovereign Wealth Fund ("SWF")

- Income earned by investment by Abu Dhabi Investment Authority, Sovereign Wealth Fund and Pension Fund in the infrastructure sector was made exempt (subject to certain conditions) pursuant to section 10(23FE) of the ITA vide Finance Act, 2020.

- This exemption is further liberalised so as to exempt income from investment in the following entities by ADIA/ SWF/ PF:

  - AIFs having minimum 50% investments in notified infrastructure businesses or in InvITs (as opposed to 100% earlier);
  - Indian holding companies set up on/ after 1 April 2021 having minimum 75% investments in notified infrastructure businesses; and
  - NBFC – IDF/ IFC with at least 90% lending to companies/ entities in notified infrastructure businesses.

- However, direct or indirect leverage by the funds is not permissible.

<u>Amendments relevant to cross-border transactions</u>

8. Clarification regarding scope of equalisation levy

- Section 163 of the Finance Act, 2016 levies equalisation levy of 2% on consideration received by an e-commerce operator from e-commerce supply or services made or provided to persons resident in India or specified non-resident or a person who buys such goods or services using IP address located in India. Further, section 10(50) of the ITA provides exemption to income arising from specified services and from e-commerce supply or services which is chargeable to equalisation levy.

- It is proposed to insert an explanation to section 163 of the Finance Act, 2016 to clarify that equalisation levy shall not apply to consideration which is taxable as royalty or fees for technical services under the ITA read with the relevant DTAA.

Katalyst Comments:

This amendment will narrow the scope of equalisation levy, in cases where income-tax has already been charged on royalties or fees for technical services and therefore, is a beneficial amendment.

- Another explanation is proposed to be inserted to section 164 of the Finance Act, 2016 to broaden the scope of "online sale of goods" and "online provision of services" for the purpose of defining e-commerce supply or service and thus, various activities in relation to purchase and sale of goods.

- Lastly, section 165A of the Finance Act, 2016 is proposed to be amended to bring within the tax net even such e-commerce operators that are merely aggregators and do not themselves own goods or provide/ facilitate services.

Katalyst Comments:

This amendment will widen the scope of equalisation levy to also include mere aggregators or ancillary service providers in relation to online purchase and sale of goods.

- The above amendments will be applicable retrospectively from 1 April 2020.

Sector-specific Amendments

9. Tax incentives to units in International Financial Services Centre (IFSC)

- Since its establishment, IFSC and business units established therein have been granted several tax concessions. Several more amendments are proposed in the Finance Bill, 2021, which are summarised below:

  - **Relocation-related amendments**

    a. Relocation of Offshore Fund to a Resultant Fund in IFSC to be tax neutral for Offshore Fund, Resultant Fund and its shareholders/ unitholders
    b. NR investors of the Resultant Fund exempt on gains from future sale, if the Offshore Fund was otherwise exempt on such gains before relocation
    c. No impact on carry forward of losses if funds are relocated

  - No business connection u/s 9 of the ITA if a fund manager of an offshore investment fund operates in IFSC, provided such fund manager has commenced operations on or before the 31st day of March, 2024

  - **Aircraft Leasing:**

a. Capital gains on the transfer of aircraft or aircraft engine leased by an IFSC unit to a domestic company eligible for 100% deduction, if the unit has commenced operations before 31 March 2024
b. Income by way of royalty on account of lease rentals paid to foreign entities exempt from tax if the unit has commenced operations before 31 March 2024

- Income of non-resident on transfer of non-deliverable forward contracts entered into with an OBU of IFSC to be exempt from tax, provided such OBU commences operations before 31 March 2024.

10. Relaxations to eligible start-ups

In order to incentivise "eligible start-up" to enhance investment, the following has been proposed–

- **Extension of Tax holiday of "eligible start-ups"**: Extension of the date of incorporation of the eligible start-up to claim the benefit of section 80-IAC by one year i.e., such start-ups whose incorporation is before 1st April, 2022; and

- **Extension of period to claim Capital Gain exemption for investment "eligible start-ups**": In order to claim capital gains exemption under section 54GB which arises from the transfer of a long-term capital asset, being a residential property, owned by the eligible assessee provided the assessee utilises the net consideration for subscription in the equity shares of an eligible start-up. This benefit of this provision has now been extended when the residential property is transferred on or before 31st March, 2021.

Katalyst Comments:

While the intent of the government is to support "eligible start-ups", the need of the hour is to not only reduce the unease of doing business in India, but also to create a robust business and regulatory environment, in addition to providing tax incentives.

11. Increase in safe harbour limit of specified immovable property

- Section 43CA of the ITA provides that if the consideration received upon transfer of an immovable property (held as stock-in-trade) is less than the stamp duty valuation, then such difference shall not be imputed as deemed consideration, provided that the difference in the values is not in excess of 10% of the consideration received.

- It is proposed to increase the said limit to 20% of the consideration, provided (i) the consideration does not exceed Rs 2 crores, (ii) the transfer of the residential unit is by way of first-time allotment, and (iii) the transfer is during the period from 12th November 2020 to 30th June 2021.

- In order to provide consequential limit to the buyers of residential property, section 56(2)(x)(b) is proposed to be amended to increase the safe harbour limit to 20% i.e. if any

person receives a residential unit for a consideration less than the stamp duty value, the difference shall not be considered as deemed income if it is not in excess of 20% of the consideration paid. However, this is only applicable to a residential unit referred to in the proposed amendment to section 43CA i.e. where consideration is less than Rs 2 crores and it is a first time allotment during 12 November 2020 to 30 June 2021.

Katalyst Comments:

Given that the pandemic has severely impacted the already affected cash flows of builders and property developers, this amendment would enable property developers to liquidate their "stock-in-trade" (i.e. residential units) at a price lower than the ready reckoner value, thereby easing cash flows for such beleaguered property developers. At the same time, aspiring buyers of residential property would also be able to purchase residential properties, without any deemed taxation u/s 56(2)(x) of the ITA, at the time of acquisition.

It is pertinent to note, however, that the above amendment only applies to sale of residential units by builders as stock-in-trade (i.e. first time allotment) and not as capital asset by existing owners to others. Perhaps, it could be exhorted that even secondary transfers (subject to certain conditions) should also avail the same relaxation as extended to property developers.

12. Incentives for affordable rental housing

- Section 80-IBA provides for deduction of an amount equal to 100% of the profits and gains derived by an assessee from the business of developing and building affordable housing project approved on or before 31st March 2021 which has been proposed to be further extended to 31st March 2022.

- Further, to help migrant labourers and to promote affordable rental housing, the scope of Section 80-IBA is proposed to be expanded to allow a deduction in respect of notified rental housing projects as well.

13. Infrastructure debt funds eligible to issue zero coupon bonds

- Presently, zero coupon bonds can be issued by any infrastructure capital company or infrastructure capital fund or public sector company or scheduled bank, notified by the Government.

- It is proposed to amend section 2(48) of the ITA to include infrastructure debt fund (as many be notified) in the list of issuers of zero-coupon bonds.

Katalyst Comments:

It is evident from the overall macro impetus provided in the present budget to the infrastructure sector that the government is focussing on boosting the infrastructure sector.

This amendment would kickstart the infrastructure investment process by, effectively, making capital gains at the time of redemption of zero coupon bonds issued at deep discount originally, tax exempt and therefore, would attract various classes of investors, ranging from retail to institutional investors and from resident to non-resident investors.

However, in order to give fruition to this intent, the government should strive to simplify the complex regulatory environment in India, and resolve a plethora of on-ground practical difficulties faced by an infrastructure developer while developing any project.

14. Rationalisation of provisions relating to tax audit in certain cases

- In order to reduce compliance burden on small and medium enterprises i.e., those persons whose aggregate of all amounts received for sales, turnover or gross receipts during the previous year in cash does not exceed 5% of the said amount and aggregate of all payments made including amount incurred for expenditure in cash does not exceed 5% of the said payment; the threshold limit for such persons to undertake tax audit is proposed to be increased from INR 5 Crores to INR 10 Crores.

Katalyst Comments:

This amendment would certainly reduce compliance burden and therefore, compliance costs for small and medium enterprises.

Amendments to the Dispute Resolution Provisions/ Assessments

15. Replacement of Authority of Advance Rulings with Board of Advance Rulings

- The Advance Ruling mechanism provides for an advance settlement of questions in relation to taxation of various cross-border transactions undertaken by a non-resident or to determine whether an arrangement would be an impermissible avoidance agreement ("IAA") under the provisions of General Anti-Avoidance Rules ("GAAR").

- However, the functioning of AAR was largely impeded on account of the fact that the posts of the Chairman (who could be retired judges of the Supreme Court, retired Chief Justice of a High Court or retired Judge of a High Court) or Vice Chairman (who could be retired judges of a High Court) remained vacant for a long time.

- Therefore, the Finance Bill, 2021 seeks to replace the AAR with Board of Advanced Rulings ("BAR"), in a phased manner, consisting of two members, each being an officer not below the rank of Chief Commissioner to ensure smooth functioning of the advance ruling mechanism.

Katalyst Comments:

While the intent of the government is to ease the process in relation to Advance Rulings, if the BAR would only consist of senior members of the Revenue Department (and not members of the judiciary, as was previously envisaged), it is unlikely that this new mechanism would be robust, especially given that the scope of advance ruling will remain unchanged (i.e. very narrow), it is likely that the rechristened AAR (in the form of BAR) would continue to remain a dead letter.

16. Provision for Faceless Proceedings before the Income-tax Appellate Tribunal ("ITAT")

- In order to impart greater efficiency, transparency and accountability to the assessment process, appeal process and penalty process under the ITA a new faceless assessment scheme, faceless appeal scheme (for appeals before the Commission of Income-tax (Appeals)) and faceless penalty scheme had already been introduced by the Government.

- In the same spirit, section 255 of the ITA is sought to be amended to provide for conferring powers to the Government to formulate a scheme for faceless proceedings before the ITAT.

Katalyst Comments:

It is necessary that any such scheme providing for faceless proceeds before the ITAT should take into account the ease with which an taxpayer can represent its case before the ITAT, especially where the case involves high stakes or involve complex matters of interpretation of law.

17. Discontinuance of Settlement Commission ("ITSC")

- The dispute resolution mechanism under the ITSC was a one-time option to the taxpayer to resolve disputes arising out of any tax assessment proceedings where the factual matrix was complex, but the said resolution mechanism was used, mainly, in relation to assessments under search and seizure proceedings.

- Under the Finance Bill, 2021, it is sought to discontinue the ITSC from 1 February 2021 and the cases which are pending as on 31 January 2021 shall be resolved by an Interim Board to facilitate phasing out of the ITSC.

Katalyst Comments:

It is important to note that the ITSC had the power to waive off the penalty or provide immunity from prosecution, which was inherently advantageous to the taxpayer in case of search and seizure proceedings. Given that the ITSC is sought to be discontinued, the imposition of penalty and prosecution for search and seizure proceedings would almost be certain, in case such proceedings are upheld during the income-tax assessments.

18. Introduction of Dispute Resolution Committee (DRC) for small and medium taxpayers – Proposed Insertion of Section 245MA in the ITA

- Taxpayers who have an aggregate income of less than INR 50 Lakhs and the variation in income in an assessment order is less than INR 10 Lakhs, shall be eligible to opt for dispute resolution by the DRC. DRC shall have the power to waive off any penalty or provide immunity from any prosecution to the taxpayer.

- There are certain conditions for a taxpayer to opt this mechanism such as the assessment as a result of search or seizure proceedings or if there is a detention, prosecution or conviction under various other laws.

- The mechanism of DRC would be through a faceless mechanism.

- Other rules in relation to the above would be introduced in due course by the Central Board of Direct Taxes.

19. Reduced Timelines of Assessment Proceedings

- Reduction in time limit for issuance of Intimation under section 143(1) of the ITA from 12 months to 9 months from the end of the financial year in which the return is furnished.

- Reduction in time limit for issuance of notice initiating assessment under section 143(2) of the ITA from 6 months to 3 months from the end of the financial year in which the return is furnished.

- Reduction in the timeline for completion of assessment from 12 months to 9 months from the end of the assessment year.

20. Revamp of Re-assessment Proceedings

- New regime introduced for re-assessment for cases of income escaping assessment including search cases to reduce litigation.

- Time limit to issue notice for re-assessment reduced to 3 years (from 4 or 6 years) from the end of relevant assessment year (reopening with prior approval of Principal Commissioner of Income-tax).

- However, the above time limit of 3 years stands enhanced to 10 years, where income escaping assessment (represented in the form of an asset) exceeds / likely to exceed INR 50 lakh or more (reopening with prior approval of Principal Chief Commissioner of Income-tax).

Other Amendments

21. Amendments in relation to TDS/ TCS

Sr. No	Relevant Section	Proposed Amendment
1.	194 - Dividends	• With retrospective effect from 1st April 2020, it is proposed that no TDS is required to be deducted on credit or payment of dividend to a business trust as defined under section 2(13A) of the ITA (i.e., REITs and InvITs) by a special purpose vehicle or payment of dividend to any other person as may be notified • ***Katalyst Comments:*** *However, it is imperative to note that, last year, dividends received by unit holders of units of REIT/ InvIT were made tax exempt, provided the underlying SPVs did not avail the benefit of lower corporate tax rate of ~25% u/s 115BAA of the ITA. While the dividend income was made tax exempt, the TDS on dividends distributed by SPVs to REITs and InvITs was subject to withholding taxes, thereby resulting in a cash flow mismatch. This amendment seeks to address the said mismatch.*
2.	194A - Interest (other than "Interest on securities")	• In addition to infrastructure capital fund, it is proposed that the provisions of section 194A should not be applicable to interest income accrued / received from an "infrastructure debt fund".
3.	194Q – Deduction of tax at source on payment of certain sum for purchase of goods. *(newly inserted section)*	• It is proposed that ***any person***, being a buyer who is responsible for paying any sum to any ***resident seller*** for purchase of ***any goods*** of the aggregate value exceeding ***INR 50 Lakh*** in any previous year, shall, at the time of credit or payment, whichever is earlier, deduct a TDS of an amount equal to 0.1% of such ***sum exceeding fifty lakh rupees*** • Further, "buyer" for this section is defined to be a person whose total sales, gross receipts or turnover from the business carried on by him exceed INR 10 Crore during the ***financial year immediately preceding the financial year*** in which the purchase of goods is carried out (excluding such persons as notified by the Central Government in Official Gazette) • ***Katalyst Comments:*** *If there is no TDS, even inadvertently, then there may be a disallowance of expenditure.*
4.	206AA - Requirement to furnish Permanent Account Number	• It is also proposed that where TDS is required to be deducted as under section 194Q by the buyer and the resident seller does not have a Permanent Account number, the highest rate of TDS as provided under section 206AA of the ITA being 20% is substituted with 5% for such transaction
5.	206AB and 206CCA - Special provision for	• With effect from 1st July 2021, it is proposed to insert two new sections (i.e., 206AB and 206CCA) in the ITA as a special provision

Sr. No	Relevant Section	Proposed Amendment
	deduction and collection of tax at source for non-filers of ITR (newly inserted section)	providing for higher rate for TDS / TCS (twice the rate under the ITA or 5%, whichever is higher) for the non-filers of income-tax return for both of the two assessment years relevant to the two financial years which are immediately before the previous year in which tax is required to be deducted or collected, as the case may be. • The provisions of the above sections would not apply where the tax is required to be deducted under sections 192, 192A, 194B, 194BB, 194LBC or 194N of the ITA. • Further, the specified person shall not include a non-resident who does not have a permanent establishment in India.

22. Additional deduction of interest on loan for residential property under section 80EEA

- In order to help first-time home buyers, it is proposed to amend the provision of section 80EEA of the ITA which provides for additional deduction of interest on loan taken for a residential property from any financial institution up to INR 1,50,000 subject to the condition that the loan has been sanctioned during the prescribed period. Such period for sanction of loan is extended from 31 March 2021 to 31 March 2022.

23. No interest for delay in payment of Advance tax instalment for dividend income

- If the shortfall in the advance tax instalment or the failure to pay the same on time is on account of dividend income other than deemed dividend income under section 2(22)(e) of ITA, it has been proposed that no interest under section 234C of the ITA shall be charged prior to receipt / declaration of dividend income, provided the assessee has paid full tax in subsequent advance tax instalments.

24. Deduction of employee's contribution to provident or superannuation fund

- As per the extant provisions of the ITA, any contribution received by the employer which is made by an employee to provident fund, superannuation fund or any other welfare fund should be considered as an income for the employer by virtue of section 2(24)(x) of the ITA. However, once the said contribution (received from the employees) is credited to the employees' account in the relevant funds before the "due date" prescribed by the relevant regulations, the same was eligible for deduction under section 36(1)(va) of the ITA.

- Further, contribution to the aforesaid funds, made by the employer itself, was eligible for deduction under section 43B of the ITA, provided the contribution was made on or before the return filing due date.

- The amendments proposed in section 36(1)(va) and section 43B of the ITA seek to clarify that the contributions received from the employees should be deposited on or before the due dates prescribed as per the relevant regulations governing the said funds. In other words, the benefit of return filing due date should not be eligible for the employees' contribution (only to the employers' contribution).

Katalyst comments:

This is yet another amendment that seeks to overturn the judgment of Supreme Court (in the case of Sabari Enterprises), which has been followed by several High Courts as well.

25. Taxation of proceeds of high premium unit linked insurance policy ("ULIP")

- No tax exemption available if the annual premium is in excess of INR 2.5 Lacs for policies taken on or after 1st February 2021.

- Amounts received on ULIPs taxable as capital gains in the like manner as equity-oriented funds u/s 112A.

D. Key Indirect Tax Proposals

1. Introduction of Agriculture Infrastructure and Development Cess ("AIDC")

- Agriculture Infrastructure and Development Cess has been introduced on import of specified goods such as such as apples, crude oil, alcohol, coal, lignite, peat, ammonium nitrate, urea etc. to finance agriculture infrastructure and other development expenditure

- The Basic Customs Duty rates has been lowered to ensure the new levy does not lead to additional burden.

- AIDC to be levied also on manufacture of petrol and high-speed diesel.

- AIDC is made applicable with effect from 2nd February 2021

Central Goods and Services Tax ("CGST Act"):

2. Removal of mandatory requirement of GST Annual Audit and filing of reconciliation statement under the CGST Act

Mandatory requirement of getting annual accounts audited and filing reconciliation statement submitted by specified professional being Chartered Accountants and Cost Accountants has been done away with.

This is a welcome step to reduce the compliance burden of the taxpayers.

3. Levy of interest on net tax paid in cash under the CGST Act

With effect from 1st July 2017, interest in case of delay in payment of tax is payable on net cash liability.

Katalyst comments:

The new proviso states that the interest for delay in tax payment is payable retrospectively on tax paid in cash net of ITC and removes the ambiguity associated with its date of applicability.

4. Other amendments under the CGST Act

- Section 74 of the CGST Act has been amended so as make seizure and confiscation of goods and conveyances in transit a separate proceeding from recovery of tax.

- Payment of tax may no longer be necessary where detention of goods is to be challenged in appeal but mandatory pre-deposit of 25% of penalty required for filing an appeal against detention or seizure order.

- For release of goods and conveyance in transit, no tax payment required, however, penalty has been increased to 200% of tax payable on goods.

Integrated Goods and Services tax Act, 2017 ("IGST Act")

5. Amendments to Zero-rated supplies under the IGST Act

- Supply of goods or services to a SEZ developer or a SEZ unit will be zero rated only when the said supply is for authorized operations

- The zero-rated supply on payment of IGST has been restricted to a notified class of taxpayers or notified supplies of goods or services

- In case of zero-rated supply of export of goods, non-realization of sale proceeds within time limit prescribed by Foreign Exchange Management Act, 1999 will attract deposit of refund and interest

Katalyst comments:

Due to the above amendment, option of payment of IGST and claiming rebate in case of zero-rated supplies will be available only in case of notified supplies or class of tax payers and not to the all taxpayers.

Customs Act, 1962 ('Customs Act')

6. Rescindment of exemptions under the Customs Act

- All conditional exemptions, unless otherwise provided, shall come to an end on 31st March falling immediately 2 years after the date of such grant.

- Also, current exemptions shall end on March 31, 2023.

7. Time-limit for inquiry or investigation under the Customs Act

For issuance of show cause notice under Customs, the time-limit of 2 years, further extendable by 1 year by the Commissioner, has been prescribed from the date of audit or search or seizure or summons.

8. Key Customs duty rate change (effective from 2nd February 2021)

Chapter heading	Particulars	Old rate	New Rate
5201	Raw cotton	Nil	5% +5% AIDC
7204	Iron steel scrap including stainless steel scrap (upto March 31, 2022)	2.5%	Nil
7318	Screw, bolt, nuts etc. of iron and steel	10%	15%
8504 40	Solar inverters	5%	20%
8512 90 00	Parts of electric lighting or signalling equipment	10%	15%
8714	Auto-parts (Two-wheeler)	10%	15%

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