

Tax Hotline

February 01, 2022

INDIA BUDGET 2022: DECRYPTED

A day before, the Indian Finance Minister ("FM"), Nirmala Sitharaman, presented the Union Budget ("Budget") of India for the financial year ("FY") 2022-23. With India's economic growth in the current year estimated to be 9.2% (highest among all large economies), the Budget focuses on promotion of the digital economy, clean energy, climate action and private investment with public capital investment.

On the reforms, the Budget proposes to introduce a trust-based governance for ease of doing business in India. In this regard, the Budget has announced that necessary amendments to the Insolvency and Bankruptcy Code, 2016 will be carried out to increase the efficiency of the resolution process and facilitate cross-border insolvency resolution along with reduction in time period for the voluntary winding up of companies from 2 years to 6 months. Further, acknowledging the extent of private equity and venture capital investments in the start-up eco-system, the Budget has announced that an expert committee would be set up to holistically examine the regulatory hurdles and other frictions that prevent further scaling up of such investments. The private equity and venture capital industry has for long been demanding clarity on applicability of goods and service tax ("GST") and income tax on carried interest. Hopefully, with the set up of the expert committee, some of these issues may get resolved. After liberalising the drone sector through the Drone Rules, 2021,¹ the Budget proposes to provide a boost to the drone industry. Start-ups will be promoted to facilitate the Drone Shakti project through varied applications for use of drones as a service (DrAAS). As an independent initiative, the use of Kisan drones in public-private partnerships will also be encouraged for delivery of digital and high-tech services to farmers including crop assessments, spraying of insecticides and nutrients. This should hopefully result in the development of agri-tech for the Indian agriculture sector. The government will also facilitate a fund with blended capital raised under co-investment models through NABARD to finance start-ups for agriculture and rural enterprises.

Further, in light of the space constraints in urban areas for setting up charging stations, a battery swapping policy is proposed to be introduced, and interoperability standards will be formulated to enable this policy. This will encourage private players to develop innovative business models for "battery as a service". The proposed battery-swapping policy and special mobility zones are welcome moves to enable the shift towards sustainable mobility and promote the EV sector.

Furthering the Government's agenda on digitalising the Indian economy, some of the key announcements include introduction of a central bank digital currency, a digital university for enhancing access to educations to students across the country, rolling out the National Digital Health eco-system, which inter-alia, comprises of the unique health identity and launching of the National Tele-Mental Health program to provide quality mental health counselling to the people.

To encourage Defence R&D, the Government also plans to allow design and development of military platforms and equipment to be taken up by private industry in collaboration with Defence Research and Development Organisation. For this purpose, an independent nodal umbrella body will be set up for meeting wide ranging testing and certification requirements.

On the direct tax front, the most significant proposal is the taxation of virtual digital assets. The Budget proposes to tax transfer of virtual digital assets at the rate of 30% irrespective of the period of holding and does not allow for any deduction in respect of expenses incurred aside from the cost of acquisition. Further, gift of such assets will be taxed in the hands of the recipient. Additionally, loss from transfer of such assets cannot be set-off against any other income. Tax is also be withheld at the rate of 1% on the transfer of such assets in certain cases.

Tax rates largely remain unchanged. However, surcharge on income tax for co-operative societies has been capped at 15% to provide them with a level playing field with companies. Further, the surcharge on long term capital gains on transfer of any type of asset (including unlisted shares) has been capped at the rate of 15%, that is, on par with that of listed shares. Additionally, dividends received by Indian companies from their foreign subsidiaries is proposed to be increased to the rate of 30% instead of the current rate of 15%. Further, the Finance Bill, 2022 ("Finance Bill") proposes to levy withholding tax on perquisites provided to Indian resident taxpayer at the rate of 10% of the value of the perquisite.

For eligible start-ups established before March 31, 2022, a tax holiday for 3 consecutive years out of 10 years from the incorporation date was provided. In response to the Covid-19 pandemic, the Budget proposes to extend this benefit to start-ups incorporated prior to March 31, 2023. Additionally, the concessional tax regime of 15% to manufacturing companies was available should such companies commence manufacturing by March 31, 2023; this date has now been extended to March 31, 2024.

In an effort to streamline the process for tax litigation, certain measures have been introduced to avoid repetitive

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appeals by the department in the higher courts. This is a positive step towards an efficient litigation resolution framework. Further, the Budget proposes to provide an ability to taxpayers to rectify any errors in their tax return within a period of 2 years from the end of the relevant assessment year.

In a welcome move, the Budget also proposes that where an income tax liability has been modified by an order of an Adjudicating Authority under the Insolvency and Bankruptcy Code, 2016, the Assessing Officer ("AO") shall modify the demand payable in conformity with such order. This would result in removal of an anomaly whereby there was no mechanism or procedure to reduce the income tax liability to give effect to such orders.

Pursuant to various judicial pronouncements on successor liability, the Budget proposes to introduce a new deeming fiction in the case of a 'business reorganization' wherein the assessments/proceedings (whether pending or completed) on the predecessor entity made during the course of *pendency* of the scheme/reorganization, are deemed to have been made on the successor.

Developments in relation to the Gujarat International Finance Tec City ("GIFT City") include setting up of foreign universities and an international arbitration centre. On the tax front, tax exemption has been proposed for income of a non-resident from offshore derivative instruments, or over the counter derivatives issued by an offshore banking unit, income from royalty and interest on account of lease of ship and income received from portfolio management services in IFSC. Separately, the Budget proposes to replace the Special Economic Zone Act with a new legislation. However, the fine print of the new legislation is awaited.

A slew of changes has also been made to the scheme under the Income-tax Act, 1961 ("ITA") for charitable organisations, search and seizure related provisions, faceless assessment, allowability of expenditure for the purposes of business or profession and penalty related provisions.

In summary, while this Budget focuses on digitalisation of the Indian economy, it has missed to address number of other key issues such as rules on offshore listing for Indian companies, creating regulatory regime conducive for Special Purpose Acquisition vehicles (SPACs), reduction in tax rates for the salaried / middle class, concessional tax rates for businesses engaged and investing into green technology etc. Further, taxation of virtual digital assets is expected to have a far-reaching impact on the crypto eco-system and it would be relevant to see how the Government further regulates such assets. We have provided below a more comprehensive analysis and further insights on the Budget proposals. Hope you enjoy reading it.

Join us for an interactive [Webinar](#) on Thursday, February 3, 2022 for insights on India's 2022 Budget.

- **International Tax Team**

CONTENTS:

TAX RATES

TAXATION OF VIRTUAL DIGITAL ASSETS

EXEMPTION OF AMOUNT RECEIVED FOR MEDICAL TREATMENT OF OR ON ACCOUNT OF DEATH DUE TO COVID-19

INCENTIVES FOR UNITS SET UP IN INTERNATIONAL FINANCE SERVICES CENTRE

RATIONALIZATION OF SURCHARGE ON LONG TERM CAPITAL GAINS TAX

SUCCESSOR ENTITIES: CHANGES FOR BUSINESS REORGANIZATION

AMENDMENT TO TITLE: HEIGHTENED PERSONAL LIABILITY RISK FOR DIRECTORS OF PRIVATE COMPANIES?

STREAMLINING REFUNDS FOR TAX DEDUCTED IN SPECIFIC SITUATIONS

EXTENSION OF DIVIDEND STRIPPING AND BONUS STRIPPING PROVISIONS

WITHDRAWAL OF PREFERENTIAL RATE OF TAX FOR DIVIDENDS RECEIVED FROM A FOREIGN COMPANY

TDS ON PERQUISITES MAY LEAD TO WITHHOLDING OF PERKS!

LITIGATION MANAGEMENT WHERE QUESTION OF LAW INVOLVED IS PENDING ADJUDICATION

RATIONALIZATION OF PROVISIONS RELATED TO RE-ASSESSMENT

ADDING WINGS TO THE NEWLY FORMED DISPUTE RESOLUTION COMMITTEE

FACELESS ASSESSMENT: REVAMP

TAX RATES

The corporate income tax rates for companies, and tax slabs for individuals broadly remain the same for FY 2022-2023. Companies will continue to be taxed at 30% if their total turnover (in the previous year 2020-2021) exceeds INR 4,000 mn (USD 53.5 mn approx), and at 25% if it does not exceed INR 4,000 mn (USD 53.5 mn approx).

Concessional tax regimes under Section 115BAA (22% rate for certain domestic companies) and Section 115BAB (15% rate for new manufacturing companies) continues to remain intact. One of the conditionalities to avail the preferential regime under Section 115BAB is for the new company to have commenced its manufacturing or

production activities on or before March 31, 2023. The Finance Bill has further extended this date to March 31, 2024.

The above-mentioned rates are exclusive of surcharge and cess, the rates for which continue to remain the same in the case of companies (i.e., 7% – 12%, depending on the tax regime they choose).² In the case of association of persons ("AOP"), their income may be subject to a graded surcharge, which could be up to 37% (if its income exceeds INR 50 mn). The Finance Bill recognizes that as per the terms of several market standard works contracts, individual companies are often compulsorily required to form consortiums (which are treated as AOPs with only companies being its members, not individuals). In such cases, the income of such consortiums are also subject to a maximum surcharge at 37%, which is far higher than the surcharge applicable to the individual companies (which form part of the consortium). To reconcile the difference between surcharge rates for individual companies, and for a consortium formed by such individual companies, the Finance Bill has proposed to cap the maximum surcharge on such AOPs (whose only members are companies) to 15%. This is a welcome move to bring the taxation of AOPs (which are only comprised of companies), at par with the taxation of individual companies.

The Finance Bill has also reduced the Alternate Minimum Tax ("AMT") rate for co-operative societies to 15%. This has been done to bring the MAT rates applicable to co-operative societies, at par with the MAT rates applicable to companies; and provide a level playing field. Further, the surcharge rate to be paid on the tax on income of co-operative societies (with total income between INR 10 mn – 100 mn) has also been reduced to 7%.

TAXATION OF VIRTUAL DIGITAL ASSETS

While the cryptocurrency space in India has been subject to regulatory resistance and ambiguity, it has nevertheless boomed in the last year and is estimated to touch USD 241 million by 2030.³ Indian investors hold crypto assets worth USD 5.3 billion.⁴ Further, news reports suggest that India has the highest number of crypto owners in the world at 10.07 crore.⁵ The boom in crypto trading can be attributed to a surge in global interest as well as the Supreme Court decision wherein the Supreme Court set aside, on constitutional grounds, a circular issued by the Reserve Bank of India, which had sought to restrict banking facilities from being offered to participants involved in cryptocurrency transactions.⁶ The Supreme Court ruling affirmed the virtual currency exchanges' fundamental right to trade and do business, guaranteed under the Constitution of India.

However, lack of guidance on the tax regime has created several open issues and grey areas for all participants in the industry. While there is no clarity on the fate of virtual digital assets ("VDAs") in India on the regulatory front, the Finance Bill has proposed the much-awaited taxation regime for VDAs in India. The following changes have been proposed under the ITA with respect to taxation of VDAs applicable with effect from financial year 2022-23:

- Definition of VDA;
- Taxing income from transfer of VDAs under section 115BBH at a special rate of 30%;
- Gift tax on VDAs;
- Withholding tax provision on payments for transfer of VDA to a resident.

We have discussed these provisions in detail below.

1. Definition of VDA:

The Finance Bill proposes to define VDA under section 2(47A) of the ITA. It seems that the definition of VDA under the Finance Bill largely draws from the definition under the Draft Banning of Cryptocurrency & Regulation of Official Digital Currency Bill, 2019.⁷

The Finance Bill provides an exhaustive but broad definition of VDA where the following criteria need to be met to qualify as a VDA (irrespective of the terminology or nomenclature):

Necessary Criteria:

- any information or code or number or token,
- generated through cryptographic means *or otherwise*,
- can be transferred, stored or traded electronically;

Additional Criteria (one of which needs to be satisfied):

- providing a digital representation of value exchanged with or without consideration, with the promise or representation of having inherent value, or
- functions as a store of value or a unit of account (including its use in any financial transaction or investment, but not limited to investment scheme);

Exclusions: Indian currency or foreign currency as defined under Foreign Exchange Management Act, 1999 ("FEMA")⁸ is excluded from the ambit of VDA meaning that anything that is Indian currency or foreign currency is automatically not a VDA.

NFT: The definition of VDA also specifically includes a non-fungible token ("NFT") or any other token of similar nature, by whatever name called. While the Finance Bill includes NFTs as a separate category in the definition of VDAs, the Finance Bill provides that definition of the term NFT will be specified by the Central Government by notification. It is also pertinent to note that the Finance Bill empowers the Central Government to notify any other digital asset as a VDA or exclude any digital asset from the definition of VDA. Therefore, from the scheme of the provisions, it appears that the legislative intent is to treat NFTs as a separate class of VDA (based on definitions to be notified in the future) and not as a something that may fall within the generic criteria set out above. The rationale for such distinctive treatment is unclear for the time being and perhaps the definition of the NFT when notified shall provide more light on the matter.

1.1 Expansive scope:

The proposed definition of VDA in the Finance Bill is very broad, and could include majority of crypto assets currently being traded online. VDAs have various use cases, although, there is no standard classification, certain authorities have classified VDAs based on their functions. For example,

- a. **Payment tokens:** certain crypto assets can be viewed as payment tokens which are used as a medium of exchange or goods or services and also as a store of value (in certain cases)⁹.
- b. **Property Tokens:** certain tokens represent rights in property.
- c. **Governance Tokens:** governance tokens allow token holders to exercise control over the ecosystem.
- d. **Utility Tokens:** utility tokens facilitate the exchange of or access to specific goods or services etc.
- e. **Security Tokens:** crypto-assets which fulfil the characteristics of 'securities' as defined under securities laws (although no crypto-assets are today regulated as securities in India) are also likely to be included in the definition of VDAs. While such tokens may represent characteristics of a 'security'¹⁰, however as per the current definition, they may be characterised as VDA only for the purpose of ITA.

The use of words 'information', 'code', 'number' makes the definition of VDA all encompassing. Further the presence of '*or otherwise*' in the phrase "generated through cryptographic means or otherwise", may be interpreted to mean that even the information or code which is not generated through cryptographic means could also be covered under definition of VDA. Due to the wide definition, even credit card / debit card reward points, airline miles, digital vouchers, in-game currencies etc. could potentially be included within scope of VDA, as they may be (i) information / code / number / token generated through non – cryptographic digital means, (ii) which digitally represent value, (iii) represent inherent value or function as unit of account or store of value and (iv) transferred, stored or traded electronically. This may have unintended consequences and should be excluded from the scope of VDAs. If one were to take a liberal interpretation of the definition of VDA, dematerialised securities, specifically foreign securities that have shares as underlying security may also get covered resulting in wide ramifications.

The Finance Minister has also announced introduction of Central Bank Digital Currency (CBDC) by the Reserve Bank of India ("**RBI**") using blockchain starting 2022-23.

1.2 Inherent Value:

One of the features in the definition of VDA is providing '*..promise or representation of having inherent value...*'. As a market standard, most of the crypto assets issued are accompanied with a whitepaper detailing technical details, concept and roadmap for growth of the crypto asset. Hence, even if a crypto asset does not have inherent value on its issuance, but the issuer promises or represents (maybe through whitepaper or any offer document submitted to SEC for instance at the time of an ICO/Initial coin Offering) that such crypto asset may acquire value in future, then the crypto asset may be considered as a VDA.

At a theoretical level, there have always been criticisms that the crypto assets do not have any inherent value, hence this could be a grey area that creates interpretational issues.

1.3 Interplay with 'currency'

Indian currency and foreign currency (as defined under FEMA) have been excluded from the scope of VDA. Currency has been defined under section 2(h) of FEMA as,

"currency" includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank".

The definition of currency is an inclusive one and it is unclear whether crypto assets are covered in such definition.

While the policy intent is clear that a bright line is being drawn separating currency and VDA, in practice there could be ambiguity with respect to where the demarcation between currency ends and VDA begins. Further, with the proposed introduction of CBDC and developments where countries such as El Salvador have recognised Bitcoin as legal tender¹¹, it is possible the ambit of Indian and foreign currency may expand, excluding certain items from the scope of VDA.

2. Taxing income from transfer of VDAs under section 115BBH:

The Finance Bill proposes to introduce section 115BBH to provide a special tax rate of 30% for taxing income from transfer of any VDAs. Such income shall be computed without taking effect of:

- a. Any deduction in respect of any expenditure (other than cost of acquisition) incurred for such transfer; or
- b. Any allowance or set off of any loss.

It is further provided that loss from transfer of VDAs shall not be permitted to be set off against income computed under any other head under the ITA. The loss shall not be allowed to be carried forward to succeeding assessment years as well.

It is pertinent to note that the tax rate of 30% is exclusive of surcharge and cess. The super-rich surcharge of 37% applicable on individuals having total income more than INR 5 crores should also be applicable to income earned from transfer of VDAs effectively taking the tax rate to 42.74%. Section 115BBH essentially puts an end to questions on characterisation of income from VDAs in so far as characterisation of such income should not matter as no deductions or set off or carry forward of losses are permitted under section 115BBH.

This is similar to the tax regime that currently exists with respect to taxation of winnings from games. The parliamentary intent appears to be that transactions in this space are booming and hence need to be taxed at the higher rate of 30%. Prior to this amendment, it was possible to categorise transactions as either trading income and claim expenses or claim long term capital gain rate of 20% based on the facts of the case. However, this special rate of 30% shall impact trading volumes as it increases the tax burden along with the tax certainty it brings.

It is likely that the industry will see a shift in trading patterns, away from seeking arbitrage or small margin large volume trading to more investment style buying and selling from investors.

3. Gift tax on VDAs:

Section 56(2)(x) is an anti-abuse provisions which deems income in the hands of the recipient, if any (i) sum of money, (ii) immovable property, or (iii) any property (other than an immovable property) is received by such recipient (i) without consideration and the fair market value ("FMV") of the property exceeds INR 50,000 or (ii) for a consideration which is less than aggregate FMV of the property by an amount exceeding INR 50,000.

'Property' has been defined under explanation to section 56(2)(x) of the ITA read with sub-clause (d) to the explanation to section 56(2)(vii) as *"property" means the following capital asset of the assessee, namely:- (i) immovable property being land or building or both; (ii) shares and securities; (iii) jewellery..."*

The Finance Bill proposes to amend the definition of 'property' to include VDAs. The term VDA has been proposed to be defined under a new section, section 2(47A) of the ITA, and has not been included under the definition of capital asset. By virtue of the proposed amendment, any gift of VDAs should be deemed to be income in hands of the recipient subject to tax at rate of 30% (plus applicable surcharge and cess).

It is however pertinent to note that not all gifts are taxable under section 56(2)(x). Section 56(2)(x) provisions certain exemptions in case of receipt of property (i) from a relative, (ii) under will or inheritance, (iii) from any trust or charitable institution registered under ITA, etc. In such cases, receipt of VDA should also not be taxable. In the crypto-asset markets, it is a common for some crypto projects to airdrop their tokens. Airdrop can be understood as a crypto project sending free tokens en masse to their communities in a bid to encourage adoption and as a means to reward early adopters.¹² In such case, if the value of airdropped VDA exceeds INR 50,000 then it could be taxable in the hands of the recipient. For certain VDAs, one can take a view that such VDAs have been airdropped because a person has used that particular VDA's ecosystem, for which he / she may have incurred certain transaction cost as well, and hence the VDA has not been received without consideration. However, this position depends on valuation and the difference in the amounts paid for the airdropped tokens. Similarly, it is also common for crypto exchanges to issue promotional tokens to their users or offer special tokens as part of the marketing or to incentivise transactions. In case the value of such tokens exceed INR 50,000, tax implications under section 56(2)(x) may be triggered, which is a particular risk where such tokens have an independent market value and trade at a certain value on the market.

4. Withholding tax provision on payments for transfer of VDA to a resident:

The Finance Bill proposes the introduction of section 194S to the ITA. Section 194S of the ITA obligates any person responsible for paying to a resident any sum by way of consideration for transfer of a VDA to withhold tax at rate of 1% at the time of payment or credit, whichever is earlier.

While the aforesaid withholding provision should technically be applicable on the buyer of VDAs and crypto exchanges (marketplace) should not be considered as 'person responsible for paying consideration', the obligation to withhold tax under section 194S may practically be on crypto-exchanges. However, with the advent of decentralised finance and evolution of smart contracts, it is possible increasingly in the future that the 'person responsible for paying consideration' may not be the exchange or the platform, in which case the buyer could directly have a tax deduction exposure.

Further, the withholding tax provision is also likely to be a deterrent to volume trading as volume trading with minimal margins may not be feasible considering withholding tax cost on each trade. This is likely to be particularly acute with respect to crypto-crypto transactions where the payments would have to be converted to INR to make the TDS payment. This would create additional currency conversion rate risks or raise operational challenges where users may have to pay INR to be able to receive the crypto into their accounts.

4.1 Exclusions: The Finance Bill provides that no tax shall be deducted under section 194S in the following cases:

- a. Where the value or aggregate value of consideration payable by specified person does not exceed INR 50,000 during a FY
- b. Where the value or aggregate value of consideration payable by a person other than a specified person does not exceed INR 10,000 during a FY

Practically, the buyer may not have the knowledge of the identity of counter party in a crypto transaction undertaken on a crypto exchange. Even if crypto exchanges were to comply with the provisions of section 194S, they will have to take details from their users to assess whether the users fall under the ambit of specified persons or not. At a practical level, assessing these details may not be possible by the buyer and hence the exchanges may have to step in based on trading data available on their platform.

4.2 Payment in kind or in exchange of another VDA: Section 194S also obligates the person responsible for paying to a resident any sum by way of consideration for transfer of a VDA to ensure that tax has been paid in respect of such consideration for the transfer of VDA in case where

- i. consideration for transfer of VDA is wholly in kind or in exchange of another VDA, where there is no part in cash; or
- ii. partly in cash and partly in kind but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of such transfer

Crypto to crypto trading is very common in the crypto ecosystem. It is unclear how the withholding provisions will operate in such cases. For example, where A sells/trades Bitcoins to B in lieu of Ether, it may be possible to interpret that both A and B should withhold tax on sale of bitcoin and ether respectively. There may also be valuation issues in case of crypto to crypto transactions. The obligation on the buyer to discharge tax in case transactions are undertaken in kind seems to be an onerous obligation on the buyers or exchanges and is likely to give rise to cash flow issues. This also creates timing issues with respect to the point in time at which the TDS is to be deducted. The section deems that a credit to the account of a user shall be deemed to be payment, which means that the INR amount for TDS payment should be available with the exchange prior to the credit of the crypto consideration to the

seller's account. This would create practical challenges.

4.3 Interplay with other withholding tax provisions: Section 194S specifically contains a non-obstante clause (section 194S(4)) to provide that if withholding has been undertaken as per section 194S, there should be no obligation to comply with other withholding or collection of tax at source provisions under the ITA. Despite the non-obstante clause, section 194S(8) specifically clarifies that in case where withholding tax provisions contained under both section 194-O and section 194S are applicable on a transaction, then it appears that tax should be deducted under section 194S only.

This is a welcome clarification and should put an end to doubts on applicability of section 194 O to crypto exchanges. However, the language of the actual text of the provision in section 194S is a little misleading and potentially suggests the opposite effect. Amending the language to make it clearer by adding "only" as suggested below would avoid any potential issues in the future.

"(8) Notwithstanding anything contained in section 194-O, in case of a transaction to which the provisions of the said section are also applicable along with the provisions of this section, then, tax shall be deducted [ONLY] under sub-section (1)."

4.4 Power to issue guidelines: Section 194S also contains a provision for the Central Board of Direct Taxes ("CBDT"), with prior approval of Central Government to issue guidelines for removing difficulties in context of the said section.

8While the proposed regime does not seem to be crypto investor friendly, the mere introduction and recognition of VDAs under the ITA is a welcome move for the industry. Further, while the policy intent for taxing income from VDAs similar to gambling transactions seems to stem from the Governments discomfort on speculative activities relating to crypto-assets, it is definitely a step in the right direction. It provides clarity on several open questions from an income-tax perspective. Having said this, there are several misses and further clarifications in this regard may be useful:

a. **Applicability of equalization levy ("EL") on crypto-exchanges:** The Finance Act, 2020 had expanded the scope of EL to apply 2% EL on the amount of consideration received or receivable by an 'e-commerce operator' from 'e-commerce supply or services' made or provided or facilitated by or through it to:

- to a person resident in India
- to a non – resident in certain specified circumstances
- to a person who buys such goods or services or both using internet protocol address located in India. (collectively as "**Specified Persons**")

Given the broad definition of e-commerce operator and e-commerce supply or services, it is possible that transactions in VDA by Indian users (especially buyers) on a foreign crypto exchange could be subject to EL. However, the Finance Bill has not provided any clarity on applicability of EL on foreign crypto exchanges.

b. **Valuation rules:** while the Finance Bill provides guidance on manner of taxation, there is no guidance on valuation of VDAs. Valuation of VDAs may be particularly complex given the volatile nature of the asset class. The value determination is particularly tricky with respect to crypto to crypto transactions where the trading rates for each crypto may vary across exchanges within a single day and there could be significant variations across regions. Therefore, determining fair market value of any crypto at a given point in time may not be possible and could lead to disputes. In many instance, this is key to determining the applicability of section 56 for example. Lack of guidance on valuation aspects may create difficulties for taxpayers to comply with the tax provisions.

c. **GST provisions:** Currently, there is no guidance on the manner in which GST provisions are applicable to transactions in VDAs. The Finance Bill also does not provide any clarity on GST provisions applicable on VDAs. In the recent past, the GST authorities have raided several crypto exchanges in India.¹³ Lack of guidance on GST aspects may create several issues on classification of crypto transaction, determination of tax base etc. Clarity on GST provisions should be the next big item in the government's checklist to provide an effective taxation regime for VDAs.

EXEMPTION OF AMOUNT RECEIVED FOR MEDICAL TREATMENT OF OR ON ACCOUNT OF DEATH DUE TO COVID-19

Employers and well-wishers have been offering financial help to taxpayers for expenses incurred for treatment of Covid-19. Similarly, financial assistance is also being extended by employers and well-wishers to families of taxpayers who lost their life due to Covid-19. Such income could be taxable as perquisite in the hands of the employee in case money was received from the employer or as income from other sources in certain other cases. Taking this into account, the Finance Ministry had earlier issued a press release allowing income tax exemption on receipt of such income. The Budget proposes to make amendments to the relevant provisions to include the above.

In this respect, the Finance Bill proposes that any income received by an employee from the employer in respect of any expenditure actually incurred by the employee on his / her medical treatment or treatment of any member of his / her family in respect of any illness relating to COVID-19, shall not form of perquisite and accordingly not taxable as salary for the employee.

Consequently, changes have also been proposed to Section 56(2)(x) of the ITA which taxes any sum of money received by the recipient for no consideration. In this regard, following exceptions have been proposed:

- i. Sum of money received by an individual, from any person, in respect of any expenditure actually incurred by him on his medical treatment or treatment of any member of his family, for any illness related to COVID-19;
- ii. Any sum of money received by a family member of the deceased person from the employer of the deceased person provided that the such sum is paid within 12 months from the date of the death of such person;
- iii. Sum of money up to INR 10 lacs (approx. USD 13000) received by a family member of the deceased person from any other person or persons provided that the such sum is paid within 12 months from the date of the death of such person.

It should be noted that the above is subject to conditions that the Government may impose by notification. Further,

family members would only include (i) spouse and children of the individual, and (ii) parents, brothers and sisters of the individual, or any of them, wholly or mainly dependent upon the individual.

Legislative amendments to include the exemptions provided in the press release is welcome. The press release did not mention the timeline within which the money should be received by the family members of the deceased which has now been clarified. While no notification in this regard has been issued by the Government up to date, it will be interesting to see what conditions are specified to avail these benefits. Further, the changes to the section have been introduced retroactively from April 1, 2020 (FY 2019-2020), and hence take into account money received by individuals during the first and the second wave of the pandemic.

INCENTIVES FOR UNITS SET UP IN INTERNATIONAL FINANCE SERVICES CENTRE

The Government along with the International Financial Service Centre Authority ("IFSCA") has been proactive in operationalizing and encouraging participation in the GIFT City India's first International Financial Service Centre ("IFSC"). The ITA contains several incentives for units located in IFSC, inter-alia including 100 percent tax holiday under Section 80LA, reduced minimum alternate tax, concessional withholding tax on interest income, exemption from capital gains tax on transfer of specified securities, special tax regime for Category-III Alternative Investment Funds ("AIFs") in IFSC etc. Reforms on the regulatory front inter-alia include relaxation of diversification norms, flexibility in co-investment, undertaking leverage by AIFs set up in IFSC, relaxations for foreign portfolio investors etc. The funds ecosystem has been gaining momentum in the IFSC with more than 20 AIFs, 6-7 portfolio managers and 4-5 investment advisors being registered with IFSCA.¹⁴

The FM has announced that world-class foreign universities and institutions will be allowed in the GIFT City to offer courses in financial management, finTech, science, technology, engineering and mathematics free from domestic regulations, except regulations issued by the IFSCA to facilitate availability of high-end human resources for financial services and technology. An International Arbitration Centre is also proposed to be set up in the GIFT City for timely settlement of disputes under international jurisprudence. Lastly, the FM also announced that services for global capital for sustainable and climate finance will be facilitated in the GIFT City.

In addition to the above announcements, the Finance Bill has proposed several changes in the ITA to make it a global hub for financial services sector:

- **Exemption from income arising from offshore derivative instruments or over-the-counter derivatives:** The ITA exempts any income which accrues or arises to or is received by a non-resident as a result of transfer of non-deliverable forward contracts entered into with an offshore banking unit ("OBU") of an IFSC from tax. The Finance Bill proposes to extend this exemption to income arising from offshore derivative instruments or over-the-counter derivatives entered with an OBU.
- **Incentives for AIFs in IFSC:** Section 56(2)(viib) of the ITA provides that where a closely held company issues shares at a premium to Indian residents, the amount of money received by the closely held company in excess of the fair market value of the shares of the company is considered as income from other sources. However, provisions of section 56(2)(viib) are not applicable where consideration for issuance of shares is received by a Category I/ II AIF registered with the Securities Exchange Board of India.

The Finance Bill proposes to clarify that this exemption is available to Category I/ II AIF registered with the IFSCA as well.

- **Incentive for encouraging portfolio management in IFSC:** The Finance Bill proposes to introduce an exemption to exempt any income received by a non-resident from portfolio of securities or financial products or funds, managed or administered by any portfolio manager on behalf of such non-resident, in an account maintained with an OBU in the IFSC, to the extent such income accrues or arises outside India and is not deemed to accrue or arise in India.

The IFSCA has introduced the International Financial Services Centres Authority (Capital Market Intermediaries) Regulations, 2021 ("CMI Regulations") to provide for a framework for operation of capital market intermediaries in GIFT City. The Finance Bill extends the aforesaid exemption to portfolio managers registered under the CMI Regulations. It is pertinent to note that according to the CMI Regulations, portfolio managers in IFSC can have the following categories as clients:

- a. a person resident outside India;
- b. a non-resident Indian;
- c. a non-individual resident in India who is eligible under FEMA to invest funds offshore, to the extent of outward investment permitted; and
- d. an individual resident in India who is eligible under FEMA to invest funds offshore, to the extent allowed in the Liberalized Remittance Scheme of Reserve Bank of India.

Portfolio managers operating in IFSC are permitted to invest in securities and financial products in IFSC, India or foreign jurisdiction (as defined in the CMI Regulations).

Having said this, the exemption provided by the Finance Bill will be available only to non-residents to the extent income is earned from securities outside India.

- **Incentives for ship leasing:** Last year, the FM introduced a competitive tax regime for aircraft leasing in GIFT City. In order to promote ship leasing in the IFSC, the Finance Bill proposes the following:
 - a. Extension of tax holiday to income arising on transfer of ship which was leased by a Unit located in IFSC subject to condition that the Unit has commenced operation on or before the March 31, 2024;
 - b. Exemption of any income of a non-resident by way of royalty, on account of lease of a ship in a previous year, paid by a unit of an IFSC if the unit has commenced its operations on or before the March 31, 2024.

The term ship has been defined to mean a ship or an ocean vessel, engine of a ship or ocean vessel, or any part thereof. While ship leasing has not been notified as a financial product by the IFSCA currently, with the proposed

change to the ITA, it is expected that ship leasing will also be included in the meaning of financial product. Entities envisaging to undertake ship leasing in IFSC are likely to obtain registration as a finance company or finance unit under the International Financial Services Centres Authority (Finance Company) Regulations, 2021.

RATIONALIZATION OF SURCHARGE ON LONG TERM CAPITAL GAINS TAX

The Finance Act, 2020 had introduced a higher surcharge for individuals falling in the rich and super-rich category. The higher surcharge on income tax results in the highest effective tax rate of between 38-42%. However, the Finance Act, 2020 had provided that in case of transfer of listed shares of a company or a unit of an equity-oriented fund, the highest surcharge on income tax would not exceed 15%. While the benefit of the lower surcharge was provided to listed entities, the same was not extended to shares of private companies.

The Finance Bill proposes to provide a level playing field and proposes to cap the surcharge on tax on long term capital gains arising on transfer of any type of assets at 15%. In respect of shares of a private company, the maximum effective long-term capital gains tax rate on sale of shares for resident Indian will reduce from 28.496% to 23.92% and for non-residents from 14.248% to 11.96%.

This step will further incentivize investments in start-ups especially from non-resident investors who will now benefit from a reduced tax of almost 3% at the time of exit. For resident investors, this will mean a reduction in the tax rate by almost 5% which will also boost private investment. It is noteworthy to mention that the surcharge on long term gains tax rate has been capped for all types of capital assets including real estate and not limited to shares of Indian companies.

SUCCESSOR ENTITIES: CHANGES FOR BUSINESS REORGANIZATION

Section 170 of the ITA provides the manner of taxation (i.e., who is assessable) in cases of succession of a business (or profession) to a person who succeeds and carries on the business (from its predecessor). The effect of Section 170 is that:

- i. The predecessor of the business is taxable/assessable with respect to the income from the business for the year of succession (only up to the date of succession);
- ii. The successor of the business is taxable/assessable with respect to the income from the business for the year of succession (only after the date of succession).

The Section thus envisages separate assessments on both, the predecessor and the successor (for which they both separately compute their taxes, apply deductions, and pay taxes as per their applicable rates). While 'succession' connotes a transfer of ownership (i.e., by way of the succession, the successor becomes the owner of the business which was previously carried on by the predecessor), Section 170 itself does not define the term 'succession', or the different ways through which succession may take place. Though the current language of Section 170 only mentions succession otherwise than by death, the intent of Section 170 has been to set out the procedure of taxation in the event of succession through reorganization or restructuring of businesses.

To clarify this intent, the Finance Bill has proposed a new definition of 'business reorganization' (for the purposes of Section 170), to mean reorganization of business involving amalgamation, or merger, or demerger, of one or more persons (i.e., schemes of arrangement).

A longstanding issue in cases of business reorganization emerges from the gap between the (i) date of issuance of an order approving a scheme of arrangement; and (ii) 'appointed date' i.e., date from which the scheme/reorganization comes into effect. In practice, the gap is because when an application is made to the relevant court for approving a scheme of arrangement, the process may usually take up to a year. As a result, the date of issuance of the order is often a year or so from the date when the application is made. On the other hand, the "appointed date" (i.e., the date from which the reorganization is effective) is set out in the application to the relevant court at the time of making the application; and thus, is most often a prior date.

Consequently, the issue that arises, is that during the pendency of the court proceedings concerning the reorganization, income tax proceedings/assessments are carried on and completed on the predecessor entity. However, the period through which the income tax assessments are carried on against the predecessor entity (i.e., when the scheme of arrangement is pending before the relevant court), is often after the "appointed date" set out in the scheme. Courts have, however, held such tax assessment proceedings/assessments against the predecessor entity to be illegal, as the predecessor taxpayer ceases to exist the moment the scheme of arrangement (i.e., the reorganization application) is approved, which could be while the income tax assessment is still ongoing.

To resolve the discrepancy mentioned above, the Finance Bill proposes to introduce a new deeming fiction through sub-section (2A) to Section 170 in the case of a 'business reorganization'. As a result of the deeming provision, the assessments/proceedings (whether pending or completed) on the predecessor entity made during the course of pendency of the scheme/reorganization application before the relevant court, are deemed to have been made on the successor. This appears to be in line with the spirit of the definition of 'demergers' in Section 2(19AA), and 'amalgamation' in Section 2(1B), both of which envisage all assets and liabilities of the demerging/amalgamating entity (predecessor) to stand transferred to the resulting entity (successor).

A second issue that emerges, is with respect to the final accounts of both entities in their tax filings during the period in which the reorganization application is pending before the relevant court. During this interim period, the predecessor entity files its tax returns accounting for the business being succeeded (as if the business is still part of the predecessor entity). Once the reorganization is approved, the business becomes that of the successor entity from the 'appointed date', which is a prior date (for which the predecessor would have already filed the returns, for that period). To rectify this issue and allow entities going through business reorganizations to file modified returns for the period between (i) date of issuance of approval order, and (ii) date of effectivity of order (i.e., when the reorganization application is pending before the relevant court), Finance Bill has also introduced a new Section 170A. As per Section 170A, the successor entity is granted a period of 6 months from the end of the month in which the approval order is issued, to file a modified return to the tax authorities.

Open Items:

While the clarifications pertaining to the procedural aspects of schemes of arrangement (business reorganization) have been clarified by way of Section 170(2A) and 170A, there are a number of crucial issues which ensue in cases of amalgamations and demergers, that continue to remain unaddressed.

- i. While Section 115JV of the ITA sets out provisions for the applicability of an AMT, if a company's income tax payable is less than 18.5% of the book profits of the company (in the previous year); there are however no express provisions within the ITA which allow or restrict the carry forward/transfer of MAT credit (accumulated at the hands of the amalgamating/demerging entity), to a resulting company on account of an amalgamation or demerger. There is a further lack of clarity as to the transferability of MAT credits during business reorganizations on account of a lack of High Court or Supreme Court jurisprudence concerning this issue. While certain ITAT rulings, have vaguely addressed the issue, the transferability of MAT credits remains prone to litigation risk (on account of there being no substantive provisions permitting or disallowing the same). As such, this continues to remain an issue that was missed by Finance Bill.
- ii. As per Section 80IA(12) of the ITA, the tax holiday/deductions available to an eligible undertaking of the amalgamating/demerging company (predecessor) should stand transferred to a resulting company (successor) for its remaining period of validity, if the eligible undertaking (for which the tax holiday is granted) is transferred by way of amalgamations and demerger. However, Section 80IA(12A) restricts such transfer of benefits to the resulting company on account of a demerger/amalgamation, if the same takes place after April 01, 2007; thereby nullifying the effect of Section 80IA(12). The non-availability of 80IA benefits granted to a business undertaking of the predecessor entity, at the hands of the successor entity, when the business undertaking is transferred by way of a scheme of arrangement, has been clarified by subsequent circulars of the CBDT as well (Circular 3 of 2008; Circular 10 of 2014).

However, as per a recent ruling of the Mumbai ITAT in Ultratech Cement Ltd [TS-1133-ITAT-2021(Mum)], section 80IA benefits have been permitted to be availed by a resulting company (successor) on eligible undertaking (business) which it has received under a scheme of amalgamation, for the residual period of the tax holiday. The rationale given by the ITAT was that Section 80IA(12A) merely neutralizes the applicability of Section 80IA(12); and does not dis-entitle the successor entity to claim 80IA benefits on the business undertaking which it receives as part of a scheme. The rationale was that even prior to the insertion of sub-section 12 to Section 80IA (which permitted the transferability of the 80IA benefits), deductions were allowed to the successor entity to which the undertaking was transferred. As such, the permissibility of the transfer was not on account of Section 80IA(12) which stands neutralized by way of Section 80IA(12A). While there are no other rulings to a similar effect, the Finance Bill should have clarified the position on transferability of 80IA benefits along with the eligible undertaking which is transferred to the successor entity by way of the reorganization.

AMENDMENT TO TITLE: HEIGHTENED PERSONAL LIABILITY RISK FOR DIRECTORS OF PRIVATE COMPANIES?

Section 179 of the ITA enables Income tax authorities to hold each director of a private company jointly and severally liable for payment of tax due from such private company where such tax cannot be recovered from the company itself, unless the director proves that the non-recovery of tax is not due to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company. While the language of the provision itself is quite broad, the title of the section is limited to "Liability of directors of private company in liquidation". The Finance Bill proposes to align the title with the scope of the provision by amending the title of Section 179 to "Liability of directors of private company", thereby ensuring that orders under Section 179 can be issued even if the relevant company is not under liquidation.

Historically, orders issued under section 179 have primarily been with respect to directors of companies under liquidation. By expanding the scope of the title, the Government has clarified to tax authorities that this provision may be used against directors of private companies regardless of whether they are under liquidation or not. This may increase the risk of directors having to prove that the non-recovery is not due to any gross neglect, misfeasance or breach of duty on their part. The tests of gross neglect / misfeasance / breach of duty themselves are wide in nature, and directors may need to be wary of this heightened risk due to the proposed change.

Moreover, the explanation to Section 179 defines the term "tax due" to include penalty, interest or any other sum payable under the Act. In order to avoid unnecessary litigation, the Finance Bill also proposes to clarify this definition by including the term "fee".

STREAMLINING REFUNDS FOR TAX DEDUCTED IN SPECIFIC SITUATIONS

Under the current tax regime, where a person has agreed under a written agreement to bear the amount of tax as applicable on an amount payable to a non-resident, and after such tax has been duly paid to the Government, the payer wishes to claim a refund on the grounds that no tax was actually required to be deducted, such person must necessarily file an appeal before the Income-tax Commissioner (Appeals).

In order to streamline the refund process, the Finance Bill proposes to insert Section 239A which provides that where the payer of an item of income (except interest) to a non-resident has contractually agreed to bear the amount of tax deductible on the item of income, such person may file an application before the AO for refund of the tax amount on the grounds that such tax was not required to be deducted; provided that the tax amount has already been paid to the Government. Such application must be filed within a period of thirty days from the date of payment of such tax to the Government, and the AO is required to pass an order within six months from the end of the month in which application was received.

In the event that the tax payer is not satisfied with the order of the AO, he can appeal the order under section 246A of the ITA.

By allowing tax payers to directly approach an Assessment Officer, the Government has taken a positive step to allow for quicker and easier resolution of claims. This is particularly important in the context of cross-border transactions where Indian resident payors often contractually agree to deduct and pay Indian tax liability amount of the non-resident payees.

EXTENSION OF DIVIDEND STRIPPING AND BONUS STRIPPING PROVISIONS

Section 94 of the ITA inter-alia contains provisions on dividend stripping and bonus stripping. Dividend / bonus stripping is an attempt to reduce the tax liability by an investor by investing in securities and units, within a specified time before the record date and receiving tax free dividend / income / additional units (as the case maybe). Thereafter, the investor exits from such security / original units after the record date at a price lower than the price at which such securities/units were purchased thereby incurring a loss. In order to prevent evasion of tax, Section 94(7) provides that loss (not exceeding the amount of dividend / income received by the taxpayer) arising on account of such purchase and sale of securities / units should not be taken into account for computing tax liability of the taxpayer. Similarly, section 94(8) provides that the loss, arising to an investor on account of purchase and sale of original units shall be ignored for the purpose of computing his total income chargeable to tax.

The Finance Bill proposes to introduce the definition of units in section 94 of the ITA. Units are proposed to mean:

- i. Unit of a business trust, i.e. Real Estate Investment Trust and Infrastructure Investment Trust;
- ii. Units of a mutual fund or Unit Trust of India;
- iii. Beneficial interest of an investor in an AIF including shares or partnership interests.

It also proposes to amend the definition of record date to include reference to business trusts and AIFs.

Therefore, going forward, the anti-avoidance provisions under section 94(7) and section 94(8) are likely to apply to investors of business trusts and AIFs as well. Having said this, in so far as provisions of dividend stripping are concerned (section 94(7)), one of the conditions for trigger of the section is that the investor receives dividend or income on such securities / units which is exempt from tax.

Considering that dividend income is now taxable in hands of the shareholders, the proposed changes may have limited applicability to AIF investors. In case where AIF is set up as limited liability partnership ("LLP") or has invested in LLP and investors get partnership distributions which are exempt from tax under section 10(2A) of the ITA, provisions of section 94(7) can technically apply. In so far as section 94(8) is concerned, issuance of units in an AIF is usually against capital contribution made by investors, therefore, there may not be a situation of bonus issuance of units by AIFs. Further, the frequent purchase and sale of units as envisaged in the provisions may not be practically possible in case of close ended AIFs and unlisted REITs, InvITs.

WITHDRAWAL OF PREFERENTIAL RATE OF TAX FOR DIVIDENDS RECEIVED FROM A FOREIGN COMPANY

The Finance Act, 2020 has abolished the dividend distribution tax ("DDT") regime. Under the DDT regime, dividend distributed by a domestic company was subject to 15% tax in the hands of such domestic company, and such dividend was exempt in the hands of the shareholder. However, since DDT was only applicable on domestic companies, dividends received by domestic companies from foreign companies was taxable at 30% in their hands. To provide a level playing field to Indian shareholders of the non – resident companies, Finance Act, 2011 introduced Section 115BBD which provided a 15% tax rate for dividends received by a domestic company from a foreign company in which the Indian company held at least 26% of the equity share capital ("Specified Foreign Company").

However, with abolishment of DDT, now dividend income is taxable in the hands of the shareholder only at the applicable rates. Hence, to provide parity in the tax treatment in case of dividends received by a domestic company from a Specified Foreign Company vis-a-vis dividend received from domestic companies, the Finance Bill has proposed to withdraw benefit of preferential tax rate under Section 115BBD with effect from April 1, 2023 and now dividends received from Specified Foreign Company is proposed to be taxed at 30%.

TDS ON PERQUISITES MAY LEAD TO WITHHOLDING OF PERKS!

Pursuant to Section 28(iv) of the ITA, the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession ("Perquisite") must be included in the taxpayer's total income and taxed under the head 'profits and gains from business or profession'.

Such Perquisites were not subject to a withholding. The Finance Bill now proposes to add a new Section 194R to the ITA pursuant to which the person responsible for providing a Perquisite to an Indian resident taxpayer shall ensure that tax has been deducted at the rate of 10% of the value of the Perquisite before providing such Perquisite.

The provision further sets out that if the Perquisite is not in the form of a cash payment, or the cash component is less than the amount required to be deducted, the person responsible for providing the Perquisite must ensure that tax has been paid in respect of the Perquisite prior to releasing the Perquisite.

For the purpose of this section, the expression 'person responsible for providing' has been proposed to mean a person providing such Perquisite, or in case of a company, the company itself including the principal officer thereof.

The obligations under this provision are only applicable if:

- i. the value or aggregate value of the Perquisite paid or likely to be paid to an Indian resident taxpayer is more than INR 20,000 twenty thousand rupees during the FY; and
- ii. if the person responsible for providing the Perquisite is an individual or HUF, then their total sales, gross receipts or turnover must exceed INR 1 crore (in case of business) or INR 50 lakhs (in case of profession), during the financial year immediately preceding the FY in which such Perquisite is provided.

This amendment is proposed to take effect from July 1st, 2022.

While Section 194R is intended to ensure that Perquisites earned by taxpayers are duly disclosed and subjected to tax, the provision creates ambiguity and adds substantial burden to providers of Perquisite ("Providers").

In the first instance, the language used in withholding provisions under the ITA generally specifically require the payor to deduct tax. In this context, the law is clear that the onus is on the payor itself to deduct from the amount being paid. However, the language used in 194R lead to ambiguity as it sets out that the Provider shall ensure that tax has been deducted at the rate of 10%. Accordingly, it becomes unclear whether the onus is on the Provider to deduct tax.

Similarly, if the Perquisite is not in the form of a cash payment, or the cash component is less than the amount required to be deducted, the Provider must again ensure that tax has been paid prior to releasing the Perquisite. This places an additional burden on the Provider to ascertain whether the Perquisite recipient has paid the full tax amount prior to even releasing the Perquisite.

In a cross-border context, as one would expect, non-resident payors typically do not have withholding obligations with respect to transactions occurring in the ordinary course of business. However, the scope of Section 194R is wide enough to require that even non-resident Providers must ensure that tax is deducted (or paid in full by the recipient) on Perquisite released to Indian recipients.

Lastly, as the law currently stands, only the recipient has the obligation to pay requisite tax on the value of any Perquisite received pursuant to section 28 of the ITA. Accordingly, the recipient was free to value the Perquisite and pay tax. However, with the proposed addition of Section 194R both the Provider and the recipient will need to deduct / pay tax on the value of the Perquisite, which will require that both parties mutually agree on a single valuation.

In an effort to close the gap on untaxed perquisites, the Government seems to have proposed a cumbersome provision which may deter Providers from offering perks altogether.

LITIGATION MANAGEMENT WHERE QUESTION OF LAW INVOLVED IS PENDING ADJUDICATION

The Budget proposes to insert a new section 158AB. This section provides that where the collegium¹⁵ is of the opinion that any question of law arising in the case of a taxpayer for any assessment year ("Relevant Case") is identical with a question of law already raised in her case or in the case of any other taxpayer, which is pending before the jurisdictional High Court or the Supreme Court against orders in favour of the taxpayer ("Other Case"), it may intimate the Commissioner or Principal Commissioner ("Commissioner") not to file any appeal in the Relevant case to the Appellate Tribunal or the High Court, as the case may be until the finality of the Other Case.

In this regard, the provisions also provide that upon receipt of communication from the collegium, the Commissioner shall direct the AO to make an application in the High Court / Appellate Tribunal stating that an appeal in the Relevant Case may be filed after the finalisation of the Other Case. Importantly, such an application may only be made if an acceptance to the effect that the facts of the Relevant Case and Other Case are identical, is received from the taxpayer. In case no acceptance is received, nothing can preclude the Commissioner from filing an appeal in the Appellate Tribunal or the High Court, as the case may be.

Furthermore, where the orders in favour of the taxpayer passed by the Commissioner (Appeals) or the Appellate Tribunal in the Relevant Case, is not in confirmatory with the final decision in Other Case, the Commissioner may direct the AO to appeal to the Appellate Tribunal or the High Court, as the case may be, against such order.

Earlier, the Commissioner had the power to prevent appeals in a Relevant Case only when the Other Case was pending in the Supreme Court. The fact that such a power has been extended even to cases pending at the High Court is a welcome move and should go a long way in reducing duplicity of matters and therefore the amount of litigation. Having said that, the act of preventing such appeals is upon the discretion of the collegium - which comprises of officers from the Revenue - given which, question arises as to the effective implementation of the intent behind introducing this provision, i.e. to reduce the amount of litigation. Further, the success of this will also depend on whether the taxpayer accepts that the facts of the Relevant Case are identical to the facts of the Other Case which is likely to mostly happen in cases where the same issue is being invoked in multiple years.

RATIONALIZATION OF PROVISIONS RELATED TO RE-ASSESSMENT

Finance Act, 2021 had completely revamped the scheme pertaining to re-assessment of income. Please click [here](#) to read our analysis in that regard. As part of the Government's initiative to rationalize the provisions related to re-assessments, the Budget has proposed certain changes. Some of the crucial changes in this regard are set out below:

Under the existing provisions, there is a requirement to obtain approval of specified authorities before issuing a notice for re-assessment at three instances, i.e. (i) at the time of serving a show-cause notice ("SCN") to the taxpayer under section 148A(b); (ii) at the time of passing of an order by the AO after taking into account reply by the taxpayer to the SCN under section 148A(d); and (iii) at the time of actually issuing a notice. In order to prevent such an anomaly, the Budget proposes that prior approval should be required only once, i.e. at the time of passing of the order under section 148A(d).

The Budget proposes to clarify that 'information which suggests that income has escaped assessment' includes any audit objection, or any information received from a foreign jurisdiction under an agreement or directions contained in a court order, or information received under a scheme notified for faceless collection of information under section 135A of the ITA. While this is a welcome move and lends some detail as to what all may be included under 'information which suggests that income has escaped assessment' it is still far from affording full clarity on what exactly constitutes such information. The intention to change the standard from 'reason to believe' to 'information which suggests that income has escaped assessment' was to bring about more objectivity in the standard for initiating re-assessment proceedings. However, owing to full lack of clarity and the subjectivity of its inclusive definition, the new standard of 'information which suggests that income has escaped assessment' seems to be going away from its original intent. Moreover, there continues to be lack of clarity on whether some of the safeguards under the threshold of 'reason to believe' such as the information obtained shall be new information etc. would apply to the new standard of 'information which suggests that income has escaped assessment.' Lastly, there is no clarity on what exactly is meant by the term 'audit objection' in the context of it constituting 'information which suggests that income has escaped assessment' - which furthers the subjectivity of its ambit.

In terms of timelines for conducting re-assessment proceedings, section 149 of the ITA provides that no notice may be issued under section 148 if (i) three years have elapsed from the end of the relevant AY; or (ii) if three but not more than ten years have elapsed from the end of the relevant AY in cases where the AO has in her possession books of accounts or other documents or evidence which reveal that income chargeable to tax, represented in the form of asset, which has escaped assessment amounts to or is likely to amount to INR 5 million (USD 66,847 approx.). The Budget proposes to enhance the scope of (ii) above by including within its ambit, income chargeable to tax represented in the form of expenditure in respect of a transaction or in relation to an event or occasion, or an entry

or entries in the books of accounts. Last year when the scheme for re-assessments was revamped, there was lack of clarity on when exactly the ten-year limitation period applies. One could take a view that since income chargeable to tax represented in the form of asset would only apply in case of tax evasion which triggers the 'search and seizure' provisions. This view is only bolstered by the Budget since it has included within the scope of the 10 year limitation period, income chargeable to tax represented in the form of expenditure in respect of a transaction or in relation to an event or occasion, or an entry or entries in the books of accounts – which also allude to instances of tax evasion leading to 'search and seizure'.

The Budget proposes to introduce a new section 148B to provide that no order of re-assessment consequent to search, survey and requisition shall be passed by an AO below the rank of Joint Commissioner, except with the prior approval of the Additional Commissioner or Additional Director or Joint Commissioner or Joint Director. This is a welcome move which seeks to ensure some level of seniority in passing of re-assessment orders arising out of search, seizure and requisition matters.

ADDING WINGS TO THE NEWLY FORMED DISPUTE RESOLUTION COMMITTEE

Finance Act, 2021 had constituted a Dispute Resolution Committee ("DRC") for specified persons subject to satisfaction of certain conditions. After the resolution of the dispute by the DRC, the assessed income of the person who applied to the DRC has to be determined, followed by issuance of demand notice and initiation of penalty proceedings, if applicable. However, the existing provisions do not enable the AO to pass an order giving effect to the orders of the DRC. In light of this, the Budget proposes to introduce a new provision to enable the AO to pass an order giving effect to the resolution of dispute by the DRC.

This is a welcome move as without this, the DRC would have been a toothless tiger. With this new provision, the matters undertaken by the DRC can now reach their conclusion.

FACELESS ASSESSMENT: REVAMP

As part of the Central Government's larger objective of streamlining the processes under the ITA to increase efficiency, the government sought to make the assessment processes electronic, by eliminating the human interaction between taxpayers and the authority (to the extent it was technologically feasible). The rationale was to optimize the usage of the department's limited resources, through a team-based assessment system across jurisdictions. Section 144B was introduced to the ITA as part of this policy through 'Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 (with effect from April 01, 2022).

Section 144B set out a detailed procedure to be followed by taxpayers and the tax department to conduct entirely faceless assessments; and its introduction marked the end of the 'Faceless Assessment Scheme' of 2019. However, given the technical and procedural challenges to implementing the faceless assessment procedures for such a large scale of taxpayers, various difficulties were pointed to the tax authorities through the course of FY 2021. The department too faced several challenges in implementing entirely faceless assessments; in so far as sub-section (9) to Section 144B, which nullified assessments made through the faceless assessment process under Section 144B, if the procedure laid down in the section was not followed. Given its recent introduction (and thus the time it would need to operate smoothly), this created an impediment for the tax departments, as a large number of disputes raised under sub-section (9) were on account of technical issues, and not procedural lapses (leading to unnecessary litigation).

In order to resolve the technical, procedural and legal issues emanating from the implementation of Section 144B, the Finance Bill has proposed to rationalize the procedure laid down in Section 144B through several amendments. Further, it has also been proposed to omit sub-section (9), which made the assessment void on non-adherence to the procedure set out in Section 144B. While this may ease the burden on the tax department, not requiring the tax department to follow the exact procedure laid down within Section 144B may question the veracity and independent nature of the faceless assessments made under the section; thereby leading to a slippery slope. Whether these amendments will succeed in curbing the procedural and technical issues from the current Section 144B, is yet to be seen.

- International Tax Team

You can direct your queries or comments to the authors

¹ The Drone Rules, 2021, available at: <https://egazette.nic.in/WriteReadData/2021/229221.pdf> (Last accessed on February 01, 2022).

² If the total income such Indian companies is (i) between INR 10 mn to INR 100 mn, the applicable surcharge is 7% of the taxable amount; and (ii) if the total income exceeds INR 100 mn, the applicable surcharge is 12% of the taxable amount. If the companies are availing the concessional tax regimes under Section 115BAB or 115BAA, then there is a fixed surcharge rate of 10%.

³ <https://economictimes.indiatimes.com/tech/technology/crypto-tech-industry-to-grow-to-241-million-in-india-by-2030-nasscom/articleshow/86478346.cms>

⁴ <https://economictimes.indiatimes.com/tech/tech-bytes/about-20-million-indians-jumped-on-to-crypto-bandwagon-in-2021/articleshow/88628547.cms?from=mdr>

⁵ <https://www.livemint.com/market/cryptocurrency/india-has-highest-number-of-crypto-owners-in-the-world-at-10-07-crore-report-11634110396397.html>

⁶ Nishith Desai Associates represented the Internet and Mobile Association of India (IAMA) in the case and played a key role in the proceedings

⁷ The Draft Banning of Cryptocurrency & Regulation of Official Digital Currency Bill, 2019 was proposed in the report of the high-level Inter-ministerial committee formed under chairmanship of Secretary, Department of Economic Affairs, to propose specific actions to be taken in relation to Virtual Currencies. The aforesaid bill was supposed to be taken up for consideration by the Lok Sabha in the winter session of the Parliament. However, the bill has not been discussed in the winter session which concluded on December 23, 2021

⁸ Section 2(q) of FEMA defines Indian currency as, "Indian currency" means currency which is expressed or drawn in Indian rupees but does not include special bank notes and special one rupee notes issued under section 28A of the Reserve Bank of India Act, 1934 (2 of 1934). Further, section 2(m) of the FEMA defines foreign currency as "foreign currency" means any currency other than Indian currency.

⁹ Example – bitcoin, ether etc.

¹⁰ Section 2(h) of the SCRA: “securities”—include (i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or a pooled investment vehicle or other body corporate; (fa) derivative; (fb) units or any other instrument issued by any collective investment scheme to the investors in such schemes; (ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; (id) units or any other such instrument issued to the investors under any mutual fund scheme; Explanation.—For the removal of doubts, it is hereby declared that “securities” shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938 (40f 1938); (ida) units or any other instrument issued by any pooled investment vehicle; (ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debtor receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be; (ii) Government securities; (iia) such other instruments as may be declared by the Central Government to be securities; and (iii) rights or interest in securities.”

¹¹ <https://www.livemint.com/news/world/el-salvador-becomes-first-country-to-use-bitcoin-as-legal-tender-11631144769412.html>

¹² <https://www.coindesk.com/learn/what-is-a-crypto-airdrop/>

¹³ <https://www.outlookindia.com/website/story/business-news-dggi-raids-half-a-dozen-crypto-exchanges-in-india-on-gst-evasion-report/407794>

¹⁴ Bhayani, Rajesh & Coutinho, Ashley. 2022, January 27. *GIFT City draws big players with biz sops; banks, PEs register with IFSCA*. The Business Standard. https://www.business-standard.com/article/economy-policy/gift-city-draws-big-players-with-biz-sops-banks-pe-register-with-ifsc-122012700029_1.html

¹⁵ Collegium shall comprise of two or more Chief Commissioners or Principal Commissioners or Commissioners of Income-tax, as specified by the CBDT in this regard.

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