

Budget 2020: These tax reforms will help govt perform a balancing act

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It's that time of the year again, when the fiscal deficit and taxation regimes begin to feature in dinner table conversations around the country. The Union Budget is just around the corner; and with the economy slowing down, taxpayers are looking to the government for some relief. Several reports have mentioned that taxpayers are hoping for rationalisation of tax rate, increase in tax incentives and simplification of tax compliances.

While the expectations of taxpayers are justified, experts predict that the finance minister would look to present a budget that primarily gives a push to the Indian economy, revives the banking sector, increases consumer spending, introduces additional measures to create more jobs and all this without pinching the fiscal deficit.

In such a situation, how can the government perform a balancing act? With little room for big-bang announcements, the finance minister can still show its support to India Inc and the honest taxpayers by aligning certain tax provisions with the intent with which they were introduced and minimising the tax obligation in certain circumstances. Let's take a look at some steps that can be considered.

Tax rate rationalisation for individuals, non-corporate entities

As evident from recent statistics, an improvement in the economy can largely be spurred by a rise in consumer spending. This makes it imperative for the government to ensure individuals have surplus cash in their hands to kick-start the consumption engine. Considering that a large section of individual taxpayers is salaried, and struggling to meet the ever-increasing cost of living in metro cities, high tax rates do not leave enough in their hands. It is also of paramount importance to bring in some parity between companies and individuals so far as taxes are concerned considering the recently introduced concessional tax rates for the Indian companies. Suggestively, the finance minister may rejig the tax rates to levy 30 percent tax on income exceeding Rs 25 lakh as against the present cap of Rs 10 lakh, enhance the interest deduction limit for a housing loan and have a relook at the thresholds for investment-linked deductions.

Similarly, to ensure a level-playing field, the government must rationalise the tax rates for non-corporate entities such as LLPs, which continue to be taxed at the rate of 30 percent, and also extend reliefs of tax neutrality for re-organisation between LLPs.

Clarifying MAT levy in case of business re-organisations

With a spurt in foreign investments and cut-throat competition, there has been significant movement in the space of mergers, demergers and other forms of restructuring. In certain form of business combinations, the shareholders following Indian Accounting Standards (Ind AS) are required to recognise the profit or loss in their statement of profit and loss on account of the difference between fair value of shares received and carrying value of the investments. This accounting treatment results in increase / decrease in 'book profit' for the purpose of Minimum Alternate Tax (MAT) due to a notional adjustment. While the government has provided relaxation in MAT levy for companies in certain cases, it is expected that the government considerably widens the ambit of relaxation to cover the above case as well. An amendment to the effect that MAT on such adjustments would be levied only at the time of disposal of such investments would be welcome.

Fair market value

The Income Tax Act provides that where certain specified property are transferred for nil or inadequate consideration, the discount given is taxed as deemed income in the hands of the buyer. To provide relief to taxpayers, Finance Act 2019 provided that this 'deemed income' provision would not be applied to cases where the consideration is approved by certain authorities and the person transferring the share has no control over such determination, and the Central Board of Direct Taxes (CBDT) was empowered to prescribe such situations. In line with the intent, the prescribed transactions to be notified would cover circumstances where the price for transfer or acquisition is fixed in the agreement whereas the actual transfer takes place at a later date due to the situation beyond the control of the parties. This would include, for instance, acquisition of listed shares which are subject to further regulatory approval. However, the CBDT has not yet prescribed the circumstances. It is expected that CBDT would prescribe the circumstances without further delay, as that would certainly help in reducing the ambiguity on the applicability of the 'deemed income' provision.

Inter-play between IBC, 2016 and IT Act

With there being significant traction in IBC cases, tax becomes one of the critical factors and in the absence of any specific exclusion, the principal portion of loans waived under one-time settlement is credited to the statement of profit and loss resulting in the levy of MAT thereon at 15 percent. While on one hand, IBC seeks to revive the corporates under financial distress, levy of MAT on the principal amount of loan waived acts as a deterrent and hence, should be done away with.

Extension of sunset date for ECB and RDB

Presently interest on External Commercial Borrowings (ECB) raised up to June 30, 2020 and interest on Rupee Denominated Bonds (RDB) payable for the period up to June 30, 2020 are eligible for a concessional tax rate of 5 percent subject to certain conditions. This lower tax rate has proved to be a game-changer by reducing the overall cost for the Indian corporates as well as for the foreign investors. The government may, therefore, consider extending the sunset date for ECBs as well as RDBs.

Shifting levy of tax on dividend

Levy of dividend distribution tax (DDT) on the companies distributing the dividend has always been considered as onerous. The corresponding levy of tax in the hands of certain specified Indian residents added to the woes of the shareholders. To streamline taxation, DDT should be abolished and dividend should be taxed directly in the hands of shareholders. Needless to say, in the case of multi-layered corporate structures, a mechanism for credit of tax paid by entities at the lower level must also be provided in order to avoid cascading of taxes.

Thin capitalisation

Finance Act 2018 introduced thin capitalisation norms under the IT Act capping the deduction of interest in relation to debt issued by a non-resident related party or where the debt issued by a third party lender is guaranteed by such related party. While the law provides that even an 'implicit guarantee' by the related party would trigger the thin capitalisation provisions, the term 'implicit guarantee' has not defined under the IT Act and is prone to interpretation. It may be better to have clear guidance on parameters to be satisfied for a transaction to be treated as having an 'implicit guarantee' from a related party.

The suggestions made herein if implemented should be more than welcoming for the government as well as for the taxpayer given that it may not disturb the fiscal deficit and provide much-needed clarification and material tax reliefs for the taxpayers.

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