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In this issue

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Foreword

Sameer Gupta
Tax Leader, EY India

India's budget for the next fiscal aims to build on the foundation laid in the last one to propel the country into Amrit Kaal. Presented against the backdrop of global recessionary trend and continued geo-political uncertainties, the budget focuses substantially on domestic growth drivers combined with tech-enabled empowerment of all deserving sectors. The biggest plus is the continued push to government's capital expenditure. With 33% capex growth planned in FY24 taking the total outlay to INR10 trillion, it will be a game changer for crowding in the private sector investments. Together with the grants to states to increase their capex, the effective capital expenditure is estimated at 4.5% of GDP in FY24. The multiplier impact of such investments can be substantial. The Government of India has managed the increased outlays while firmly adhering to the fiscal consolidation path, which is commendable.

India has shown leading growth across the major global economies this fiscal. Budget 2023 presents a solid roadmap for this continued trajectory with guiding principles set around inclusion and sustained growth.

On the tax front, Finance Minister Ms. Nirmala Sitharaman has focused on stability and, with this objective, deferred some of the widely expected simplification proposals. Another visible thread is the rationalization of financial instruments giving tax benefits, especially to HNIs. This is reflective in gains from transfer / redemption of Market Linked Debentures now deemed as short-term capital gains, long-term capital gains deduction for investment in residential house property restricted to INR10 crores, and life insurance policies with aggregate annual premium of more than INR5 lakhs made taxable.

The Budget continues its earlier trend of plugging loopholes and broadening the TDS scope. Taxpayers have been disappointed with the decision to not extend the sunset dates in respect of setting up new manufacturing companies for lower (17.2%) corporate tax rate and lower withholding tax on external commercial borrowings and rupee denominated bonds and debt investments by FPIs. In view of the recent geo-political uncertainties, an extension would provide some more room for considering fresh investments. Businesses still hope for an extension of the sunset date at the stage of enactment of Finance Bill, 2023.

In line with global trends to simplify personal tax compliances while allowing for simple standard and pension deductions, the Budget makes the concessional tax regime as the default option. The move will leave more in the hands of citizens and encourage greater consumption and investments.

The 'angel tax' scope has widened and private companies, including start-ups, while raising capital from foreign investors, will need to be mindful of the fair value to avoid tax implications. GIFT IFSC (International Financial Services Centre) is a key initiative by the Government with several key policy announcements being made in this Budget as well.

Customs duty changes are aimed to encourage exports, green energy and domestic manufacturing. The emphasis on encouraging formalisation of the economy by penalising cash transactions / unregistered entities continues in this Budget.

This issue of 'EY India Tax Insights' covers the above themes, and more. We hope it helps you understand the key policy drivers that are affecting businesses in India.

As always, we look forward to your feedback and suggestions.

In this issue

Dr. C. Rangarajan
Former Chairman, Prime Minister's Economic Advisory Council and Former Governor, Reserve Bank of India.

Dr. D.K. Srivastava
Chief Policy Advisor, EY India

Fiscal consolidation in India: charting a credible glide path

- *Introduced in 2003, the Fiscal Responsibility and Budget Management Act (FRBMA) aims to keep fiscal deficit under check.*
- *India's fiscal deficit to GDP ratio peaked during pandemic.*
- *The government is persistently working towards reducing fiscal deficit, as seen in Budget 2023 as well.*

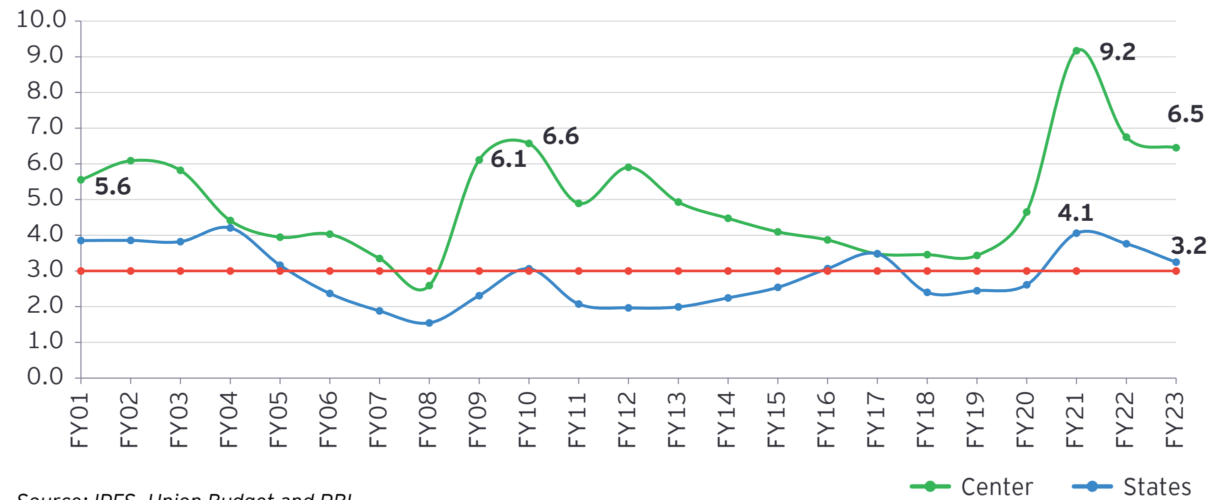
This article is co-authored by C.Rangarajan, Former Chairman, Prime Minister's Economic Advisory Council and Former Governor, Reserve Bank of India, and D.K.Srivastava, Chief Policy Advisor, EY India and Former Director, Madras School of Economics.

Fiscal consolidation so far: success and failures

The Government of India in 2003 enacted the Fiscal Responsibility and Budget Management Act (FRBMA), which focused on reducing the fiscal deficit of the country. However, it was only in FY08 when the fiscal deficit was brought below 3% .States, who enacted their individual Fiscal Responsibility Legislations (FRLs) from 2002 to 2010 considered together, were more successful in keeping their fiscal deficit below 3% in many years.

Bringing union government's revenue account in balance or surplus was also the part of the 2003 FRBMA and was hence, endorsed by the Twelfth Finance Commission. It became a feature of states' FRLs. However, in the 2018 amendment to the union government's FRBMA, revenue account balance as an objective was given up. The amended Act specified the debt-GDP targets for the union government, states and their combined accounts at 40%, 20% and 60% respectively while the fiscal deficit to GDP targets were kept at 3% each for the union government and aggregate of states.

Chart 1: Fiscal deficit relative to GDP: union government and states



Source: IPFS, Union Budget and RBI

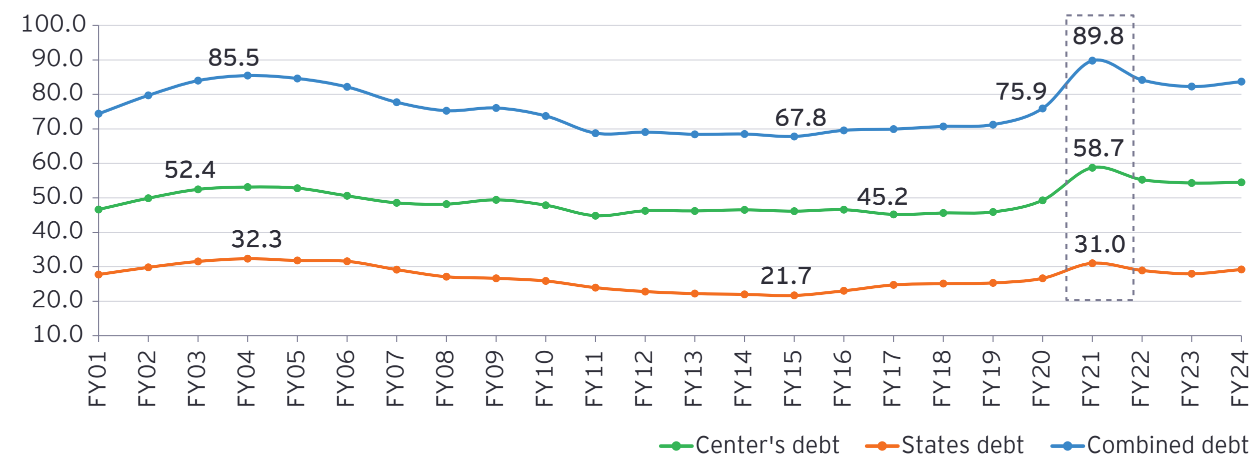
Note: (1) +ve indicates a deficit and -ve indicates a surplus. (2) Fiscal deficit-GDP ratios have been estimated by using NSO's latest GDP data released on 28 February 2023. (3) States' fiscal deficit for FY22 and FY23 is as per the RE and BE from RBI. Centre's FY23 fiscal deficit is as per the RE given in the FY24 Union Budget.

COVID-19-induced slippages

Chart 2 shows the profiles of the debt-GDP ratio of the central and state governments and on their combined account. The combined debt-GDP ratio had peaked in FY04 at 85.5%. It fell to 67.8% in FY15 after which it increased progressively to 75.9% by FY20.

With the onset of COVID-19 in FY21, India experienced a negative growth of (-)5.7% as per NSO's second advance estimates. Even the nominal growth in this year was negative at (-)1.2%. This resulted in a major deterioration in the debt-GDP ratios across the board. The consolidated debt-GDP ratio increased sharply to close to 90% with union government's debt-GDP ratio (excluding any on-lending to states with external debt estimated at the current market exchange rate) at 58.7% and that of states at 31%. The combined debt-GDP ratio exceeded the benchmark by nearly 30% points. Union government's fiscal deficit to GDP ratio in the COVID-19 year peaked at 9.2%, well in excess of the operational target of 3%.

Chart 1: Fiscal deficit relative to GDP: union government and states



Source (basic data): IPFS, MoF, Union Budget FY24

Note: (1) Centre's net liabilities excludes all on-lending to states. It includes external debt estimated at the current market exchange rate. (2) The combined debt-GDP ratio is the sum of central net liabilities excluding all on-lending to states and states' liabilities.

Union government's FY24 Budget: charting a credible glide path

The union budgets post FY21, with positive growth rates and some effort at fiscal consolidation, resulted in a fall in the union government's fiscal deficit to GDP ratio to 6.8% and 6.5% in FY22 and FY23, respectively. This effort was strengthened in the FY24 budget, where in spite of global economic headwinds, central government persisted with fiscal consolidation. Compared to a reduction of 0.3% points in FY23, the budgeted reduction in the fiscal deficit-GDP ratio in FY24 is 0.5% points, which according to present indications is further to be accelerated to an annual reduction of 0.7% points in the next two years, enabling a fiscal deficit level of 4.5% of GDP by FY26 (Table 1). In FY24 budget, the union government is focused on capital expenditure growth (37.4%) while limiting revenue expenditure growth to 1.2% with a view to taking advantage of the high capital expenditure multiplier. According to RBI (2019), union government's capital expenditure peak multiplier was estimated at 3.25 while that of revenue expenditure is 0.45.

Table 1: Union government's debt and fiscal deficit relative to GDP (%): glide path

Item	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26
Nominal GDP growth	11.0	10.6	6.2	-1.2	18.4	15.9	10.5	11.0	11.0
Fiscal deficit-GDP ratio	3.5	3.4	4.7	9.2	6.8	6.5	5.9	5.2	4.5
Debt-GDP ratio	45.6	45.9	49.3	58.7	55.1	54.1	54.5	54.3	53.5

Source (basic data): Union Budget FY24 and NSO

Notes: (1) GDP magnitudes up to FY23 are as per the latest NSO release (28 February 2023). For FY24, budgeted nominal growth of 10.5% is used. For subsequent years, a nominal growth of 11% is used. (2) In calculating Centre's debt, any on lending from Centre to states is not included and external debt is evaluated at market exchange rates. (3) Debt-GDP numbers may not tally with the numbers given in the Union Budget due to adjustments mentioned in notes (1) and (2)

Government borrowing is a pre-emptive claim on the economy's available investible resources. In India, it is only the household sector which has an investible surplus in the form of financial savings which presently amount to 8% of GDP. Supplementing this by a net capital inflow from abroad of nearly 2.5% of GDP, total investible resources add to 10.5% of GDP. In FY24, the combined fiscal deficit of central and state governments may amount to 9.4% of GDP, leaving limited scope for borrowing by the private sector and the PSUs. As combined fiscal deficit is brought down, progressively more investible resources would become available for the private sector. In the years after FY26, union government's fiscal deficit may be allowed to fall by higher margins of say 0.75% points of GDP per year with a view to reaching the FRBM target in the next two years.

By FY28, a fiscal deficit-GDP ratio of 3% would be reached, but according to our estimates, assuming a nominal growth of 11%, the debt-GDP ratio would be close to 50%, 10% points above the FRBM target. Continuing with an 11% nominal growth and retaining a fiscal deficit-GDP level of 3%, the debt-GDP ratio is expected to reach 40% by FY35. As government debt as a proportion of GDP falls, the effective interest rate on government debt would also fall, reducing the interest payment to revenue receipts ratio, thereby facilitating the accelerated pace of reduction in fiscal deficit for reaching the desired target. If the implicit price deflator-based inflation is kept at 4%, a real GDP growth of 6.7% would be required over this period. Sustaining a growth rate at this level would require a suitable growth in private investment. It is only achieving the FRBM norms and adherence to these over a long period that would leave enough investible resources for the private sector to contribute to growth.

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How Budget 2023 has increased the attractiveness for GIFT IFSC?

- *Union Budget 2023 has empowered GIFT IFSC by delegating the registration/approval power that earlier lied with SEZ authorities to the IFSCA*
- *A single-window registration system will simplify the approval process and boost ease of doing business*
- *ODIs issued by FPI and regulated by IFSCA will be considered as valid and legal contracts*
- *Acquisition financing by IBUs of foreign banks in GIFT IFSC may open a new business opportunity for foreign banks*

India's progress over the last decade has been remarkable. Indian economy is set to achieve the US$5 trillion vision set by the Hon'ble Prime Minister fairly soon. As per EY's Report[1], India is expected to achieve rapid growth and in next 25 years, the economy is likely to achieve a size of US$26 trillion by the year 2047.

The Government of India (GoI) recognises that in a globalized world, global capital will act as an important driver of economic growth and a strong Financial Sector would be a key constituent in India's growth story. GIFT IFSC (Gujarat International Finance Tec-City - International Financial Services Centre), India's first International Financial Services Centre (IFSC) launched in 2015, is expected to play a pivotal role in this journey by tapping global capital flows to meet India's development needs and provide a globally competitive financial platform for the full range of international financial services.

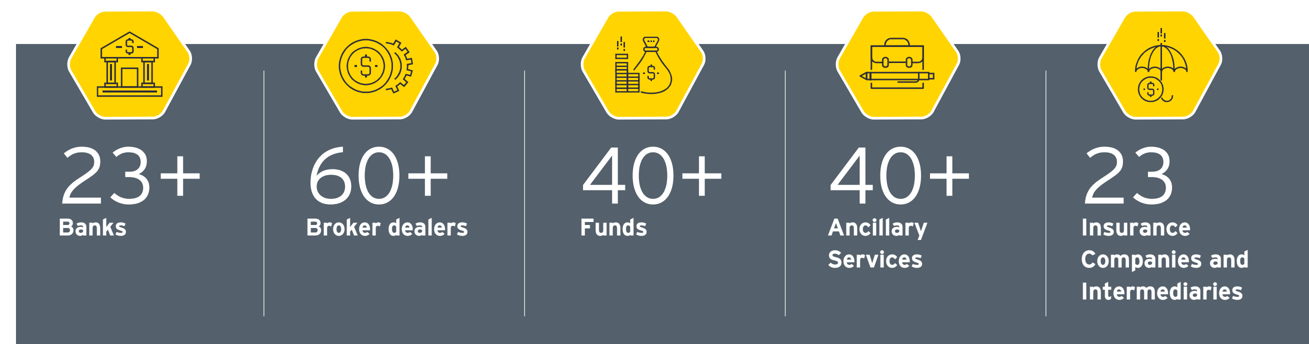
One of the many advantages of GIFT IFSC (located between Gandhinagar and Ahmedabad) is that it houses India's first IFSC, which enables registered entities to operate, innovate and succeed, facilitated by an internationally comparable regulatory framework under a special offshore status within India. It is already ranked third by the Global Financial Centres Index[2] as one of the 15 centers that is likely to become more significant in the next few years.

1. https://www.ey.com/en_in/india-at-100
2. https://www.longfinance.net/media/documents/GFCI_32_Report_2022.09.22_v1.0_.pdf

The GIFT IFSC has captured the imagination of the financial services industry since the constitution of International Financial Services Centre Authority (IFSCA) in 2020, the unified regulator for financial institutions, products and services at GIFT IFSC, with a special focus on the ease of doing business. The GoI also provides several fiscal incentives with a view to encourage businesses to be set up in GIFT IFSC. These include:

- Income tax holiday for 10 continuous years (out of 15 years) for units set up in GIFT IFSC
- Favourable taxation regime for funds set-up in GIFT IFSC comparable to the treaty jurisdictions, such as Singapore/ Mauritius
- Exemption from the goods and services tax and custom levies

As testimony to the efforts of the IFSCA and GoI, the volume of business activities in GIFT IFSC has seen notable growth across various sub-sectors of financial services. (See Table for details)



Synopsis of Growth in GIFT IFSC*	Dec 2022	Sept 2020
Units in IFSC at GIFT IFSC	400+	129
Stock exchanges - Average daily turnover	US$21.2 Bn	US$3.4 Bn
Amount committed to Alternative Investments Fund	US$10.7 Bn	Not enabled
Banking Asset size	US$35 Bn+	US$14 Bn
Cumulative Banking transactions	US$350 Bn+	US$45 Bn
Cumulative Derivative transactions	US$500 Bn+	US$22 Bn
Gross premium booked by Gift IFSC Insurance Office	US$187 Mn	NA
Re-insurance premium arranged by Insurance Intermediaries in GIFT IFSC	US$552 Mn	NA
Employment in GIFT IFSC	5,000+	2,500+

**Source IFSCA*

Union Budget 2023 **announcements**

The Hon'ble Finance Minister in her Budget speech made some key policy announcements for further enhancing growth and development of GIFT IFSC's ecosystem. An overview and impact of the announcements are discussed here:

Powers under the Special Economic Zone (SEZ) Act, 2005 to be delegated to IFSCA

Entities in GIFT IFSC are currently required to obtain registration/ approval from the SEZ authorities, prior to seeking approval from IFSCA. With an object of further enhancing ease of doing business, it is proposed that the powers of the SEZ authorities in the GIFT IFSC zone shall be delegated to IFSCA. This further strengthens the power of IFSCA as a unified Financial Services regulator for GIFT IFSC.

Single-window IT system to be set-up for registration and approval from IFSCA, SEZ authorities, GSTN, RBI, SEBI and IRDAI

A single-window registration, which also extends to RBI, SEBI and IRDAI, may provide a significant boost to ease of doing business in GIFT IFSC. While the fine print is awaited, if this eliminates the need for participants to seek separate No Objection Certificates (NOCs) from their onshore regulators in India for setting-up a presence in GIFT IFSC, this will mean inter-regulatory issues (if any) can be resolved faster and this would significantly accelerate the time taken to launch operations in GIFT IFSC.

GSTN- Goods and Services Tax Network
RBI- Reserve Bank of India
SEBI- Securities and Exchange Board of India
IRDAI- Insurance Regulatory and Development Authority of India

Offshore derivative instruments (ODIs) to be recognized as valid contracts and tax relaxation for non-resident ODI holders

The Budget 2023 proposes to amend section 18A of Securities Contracts (Regulation) Act, 1956 (SCRA) to provide that ODI contracts issued by a Foreign Portfolio Investor (FPI) in GIFT IFSC and regulated by the IFSCA shall be legal contracts. This clears the path for Offshore Banking Units (IBUs) of foreign banks in GIFT IFSC to issue ODIs with permissible Indian securities as the underlying asset.

There already exists a favorable tax regime for IBUs in GIFT IFSC investing in Indian fixed-income securities under the FPI route, for taxation of interest as well as capital gains income [comparable/better than that available under India-Singapore tax treaty]. Additionally, in order to eliminate friction in taxation, it is proposed that income distributed by IBUs shall (subject to certain conditions) not be taxed in the hands of non-resident ODI holders.

The proposal is expected to encourage IBUs of foreign banks to issue ODIs to their clients. It remains to be seen whether following the SCRA amendment, the IFSCA will also, over time, permit FPIs set up as Alternative Investment Funds (AIFs) in GIFT IFSC to issue ODIs.

Relocation of Funds

The Budget 2023 proposes to extend the time for tax-neural relocation of funds from overseas jurisdictions into GIFT IFSC from the current 31 March 2023 by another two years. This will provide additional time to asset managers who have just been licensed to operate in GIFT IFSC or are in the process, to not only look at greenfield funds but also migrating existing offshore funds into GIFT IFSC.

IBU of foreign banks permitted to undertake acquisition financing

Currently, Indian External Commercial Borrowings (ECB) regulations do not permit lending by foreign lenders for equity investments, thereby restricting their ability to fund Indian corporates seeking to make domestic acquisitions. Therefore, financing for a domestic acquisition is generally procured from non-banking financial companies (NBFCs) or by the issuance of non-convertible debentures (NCDs) by the acquirer, which can be subscribed to by FPI.

Permitting acquisition financing by IBUs of foreign banks in GIFT IFSC may open a new business opportunity for foreign banks and will also open an additional avenue for the Indian corporates to raise finance for domestic acquisitions.

With quick and decisive steps taken by the GoI and IFSCA over the last few years, the GIFT IFSC is gaining critical mass in a short time.

Every serious financial services player in the Indian market, whether domestic or global, may need to consider the regulatory and tax arbitrages of setting up a presence in say Singapore/ Mauritius or even mainland India vis-à-vis a GIFT IFSC.

The importance of GIFT IFSC will coincide with the growth of the Indian economy and the rise in sophistication of the financial services ecosystem in the country.

Sonu Iyer
Partner and National Leader, People Advisory Services, EY India

Is the simplified new tax regime the right step to provide a better taxpayer experience?

- *An efficient tax policy aims to keep at the tax rates low, allow very few exemptions and deductions and make compliance easier.*
- *However, the transition to such a tax system might not be easy, given the high tax rates, and a plethora of deductions and exemptions in the Indian tax system.*
- *The finance minister announced some changes in the new regime for the individual taxpayers.*

The Finance Act, 2020 introduced an optional concessional tax regime with lower tax rates sans most deductions. However, this regime could not bring into its fold many taxpayers, as most taxpayers have been availing deductions and exemptions and have been able to optimize their tax bill. Thus, the old tax regime, with its offer of deductions/exemptions, continued to be popular.

Budget 2023 attempted to make the concessional tax regime (CTR) more attractive by introducing standard deductions, by enhancing the maximum amount of income not chargeable to tax from

INR2.5 **lakh to** INR3 lakh

the new tax regime also has a widened the slab with lower tax rates, reducing the surcharge for income over INR5 crore, increasing the income threshold for a rebate from

INR5 **lakh to** → INR7 **lakh**

so that those earning up to INR7 lakh of taxable income do not pay any tax.

Also, CTR /new tax regime will henceforth be the default tax regime and the taxpayer will need to specifically opt for the old regime if they wish to do so.

Government hopes that many taxpayers will shift to the new tax regime. However, the fact remains that taxpayers may have to do an evaluation of their personal circumstances to assess whether they continue with the old tax regime with deductions or move to the new tax regime.

It is likely that a taxpayer who claims deductions of INR375000 and above at an income of INR15,50,000 and above will still continue with the old tax regime.

Particularly for salary income earners, deduction for rent paid against house rent allowance or LTA could make a taxpayer stay with the old tax regime for now. The direction for tax policy is clear and it is likely that eventually we will have a single tax regime without deductions/ exemptions. Meanwhile, this selection of the personal tax regime (old vs new / concessional) can be made every year depending on a comparison of the tax cost estimate under the two systems for salaried and non-business/non-professional taxpayers.

Case in favor of a simplified new tax regime is that it would simplify matters for employers and taxpayers. Employers need not worry about collecting evidence of rent paid, travel expenses, investments made, payment of interest on housing loans, etc. The taxpayer's return would also be simple and transparent, reducing tax disputes. The young taxpayers may forego deductions and pay some extra taxes under the simplified tax regime since claiming deductions would have meant cash getting blocked in certain investment instruments like insurance policies, government run pension plans etc., that might not be their preferred investment instruments. Sections like 80C push individual taxpayers to invest in identified investments for tax deductions but with the new tax regime the young taxpayer might prefer to pay the extra tax and invest their funds where they deem more appropriate, including equity shares in the stock market, investment in start-ups or even spend it if they so prefer.

For the tax administration,

the ease of compliance helps taxpayers to voluntarily file tax returns without hassles, thereby getting more taxpayers into the tax system.

Larger volume of taxpayers' data in the data bank creates opportunities for the tax administration to increase detection of transactions that might have resulted in leakage of taxes and perform analytics for more agile tax policy. Given digitization, the interplay of the data collected from various sources like, banks, credit card companies, travel agents, stock market, etc with the taxpayers' tax return data would help to ensure better tax collection.

Budget 2023 also continues to work on the agenda of plugging avenues for tax planning for High Net worth Individuals (HNIs) such as introducing cap of INR10 crores for capital Gains exemption on sale of residential house (section 54 of Income Tax Act 1961) and or sales proceeds on sale of long-term asset (section 54 F of Income Tax Act 1961) which can be justified on grounds of equity and need for revenues to offset lower tax rates. Similarly, streamlined tax benefit for high premium insurance and market linked debentures are outcomes of the data analytics that suggest misuse of beneficial provisions by HNIs.

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How amendments in angel tax will impact companies?

As per section 56(2)(viib) of the Income Tax Act, 1961, any premium received by a company (other than a public listed company) from a resident, exceeding the Fair Market Value (FMV) of the share issued is liable to tax in the hands of such company.

This provision was inserted by the Finance Act, 2012 to prevent the circulation of unaccounted money as share premium and is commonly referred to as 'Angel tax'. Possibly, given that non-resident investors have additional compliances under exchange control, require registrations in a foreign country, investments by non-residents were kept out of angel tax provisions. While the provisions of this section are applicable to the issue of all types of shares, issuance of instruments like convertible debentures would not attract the aforesaid provisions.

In contrast to the expectation that the government would grant relief to resident investors by repealing Angel tax, the government has sought to bring in parity in taxation by extending the provisions to non-resident investors. The Finance Bill, 2023, now proposes to remove the condition of residency from the section, making it applicable even when shares are being issued to non-resident investors. This amendment would impact shares issued and consideration received on or after 1 April 2023.

As per the foreign exchange pricing guidelines in India, shares issued to non-resident investors cannot be below the FMV of the shares, which acts as a pricing floor. Angel tax now seeks to tax any amount received more than FMV as income in the hands of the company. As a result, the only tax efficient option for a company would be to procure investment at the exact FMV of the shares, which could impact the price negotiations of an investment.

Such a move may also reduce the allure for foreign investors looking to invest in India or force certain start-ups to consider having their holding structure overseas to avoid pressure from foreign investors who are concerned about the impact of the proposed amendment.

However, certain relaxations have been provided by the Government of India to simultaneously enable and promote foreign investment in Indian companies.

Exemption under this section would be available to recognized start-ups (which have filed a declaration in Form 2 with the DPIIT) issuing shares to resident and non-resident investors. Further, as is the case presently, investment in Indian companies through specified funds like AIFs would remain outside the ambit of this section.

The start-up sector needs an enabling policy environment, particularly amidst the current global headwinds. Considering this, the government may consider withdrawing the proposed amendment to section 56(2)(viib).

Alternatively, specific exemption under this section may be provided to:

- Non-resident entities registered with Reserve Bank of India (RBI)/ Securities Exchange Board of India (SEBI) equivalent regulatory authorities in their respective countries, e.g., entities coming from Financial Action Task Force whitelist jurisdictions;
- Entities/ funds qualifying as Category I Foreign Portfolio investors under SEBI FPI Regulations 2019, even if not registered with SEBI; and
- Direct/ Indirect investment by sovereign wealth funds and pension funds qualifying as per definition u/s. 10(23FE) even if not notified as "specified person" u/s. 10(23FE)

Further, safe harbour mechanism/ tolerance limit up to 25% may be provided where shares are issued at a price higher than valuation report by category - I merchant banker. Any valuation disputes beyond the 25% tolerance limit should first be referred to an approval panel (just as in the case of GAAR) for a fair evaluation of the case.

The amendments may force the unlisted Indian companies to consider alternatives which could be explored to alleviate the impact of the proposed amendment. The companies could expedite and finalize any fund raise from foreign investors, which is in the pipeline, such that the infusion is completed on or before 31 March 2023 as the amendment would only come into effect from 1 April 2023. Investors could also look at viable options to register and operate in India through AIFs, at least for their India investments.

Neetu Vinayek
Partner and Tax Leader for Infrastructure and Oil & Gas sector, EY India

Sunset clauses
in India are truly setting

- *While the government is taking long strides to boost the economy, equal participation is expected from the private sector.*
- *To attract private participation along with stable policies, an attractive tax framework may provide a significant fillip to generate interest from both domestic and foreign parties.*
- *Many industries were anticipating extension of the sunset date for the concessional tax regime.*

With the vision of 'Amrit Kaal', the government allocated an unprecedented amount of INR 10 lakh crores toward capital expenditure in the country's infrastructure– a

33% increase compared to the previous fiscal year.

Out of which, the highest amount is allocated to the Ministry of Road Transport and Highways followed by the Ministry of Railways which comprises approximately 50% of the total capital allocation[1]. Among other major announcements, the government has announced significant allocation to encourage generation of new energy which is toward the path of achieving India's target of net zero committed in global forums.

To reduce dependency on imported goods and technology, the government in 2019 had announced a

concessional tax regime of* 17.16% *for new companies engaged in the manufacture/production sector.

However, such taxpayers need to commence their manufacturing/ production operations by 31 March 2024. Several entities were encouraged to set up their facilities; however, the above requirement of commencement before 31 March 2024 was not feasible for many taxpayers as the country witnessed lock down at various stages and restricted movement between the year 2020 to 2022.

Setting up a manufacturing facility itself is capital intensive and needs time, hence it was expected that the above time limit of 31 March 2024 will be extended by another three to five

1. https://www.indiabudget.gov.in/doc/eb/sumsbe.pdf

years. Such initiative could support provisioning of indigenous raw material, which in turn can support nation building and achieve ambitious targets in infrastructure.

Keeping in perspective the government's green energy mission, reliance on indigenous products like electrolyzers, energy storage equipment may become critical for reliable source of energy. Such production would entail R&D, capital infusion, demand creation, etc., and hence extension of the sunset date for the concessional tax regime was highly anticipated by multiple industries. To address these limitations, representations are made at various forums for the extension of aforesaid sunset date and suitable amendment is warranted in Budget for fiscal year 2024, if not by way of amendment at enactment stage of Finance Bill 2023.

Another important aspect from infrastructure standpoint is funding. Usually, large-scale infrastructure projects are awarded under a concession agreement under a public private partnership (PPP) model where the concessionaire is required to arrange for funds to develop the infrastructure. Even under the HAM model for road contracts, the government provides initial support only to the extent of 40% of the contract value and balance portion is to be arranged by the private developer. There are limited options for developers to arrange funds from local sources and one way to raise funds was from foreign portfolio / institutional investors, foreign lenders, etc.

Certain form of borrowing under the extent foreign exchange regulations from such parties attracted a lower tax rate of 5% (plus surcharge and cess) on interest payable to foreign company's if the agreement is entered into or funds are borrowed before 01 July 2023 or in case of foreign portfolio / institutional investors where interest is payable before 01 July 2023. While the government has announced setting up of infrastructure finance secretariat for more private investments in infrastructure, from a tax policy standpoint it could consider extending the concessional tax rate for borrowing from foreign countries at least for another year such that funding requirement in infrastructure building can be secured at reduced cost. As an alternative, finance from GIFT city could now be explored with renewed interest.

> While on one hand application of aforesaid concessional tax regime has been extended to co-operative societies by proposing an amendment in the Budget proposal for 2023, the requirement of commencement of manufacture/ production by 31 March 2024 also applies for such taxpayers and it can be said that the window provided to commence operations is too short.

Manmay Y Chandawalla
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has also contributed in this article

How Budget 2023 changes are likely to impact e-commerce operators in India?

- *What was an already rapidly evolving sector in India, e-commerce has grown immensely in the post-COVID era with sales of US$9.2b in FY22[1].*
- *To enable higher commercial activity online, Government of India is creating sovereign digital platforms like Open Network for Digital Commerce (ONDC).*
- *Changes related to GST announced in the latest budget are also likely to impact e-commerce companies.*

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Partner, Indirect Tax, EY India

Pratik Sampat
Pratik Sampat - Director, Indirect Tax, EY India

Union Budget proposals recently announced have focussed on two aspects of e-commerce

A Enabling composition 'goods' sellers on online platforms

Currently, persons supplying goods up to a turnover of INR15 million (INR7.5 million in specified states) have the option to opt for a composition scheme for payment of GST. Under this option, the supplier has to pay tax on the turnover (ranging from 1 to 5%) without recovering any input tax credits. Only "within state" sales are permitted. Taxes paid under composition are not recoverable by buyers. This scheme works well for suppliers in B2C space. This option was not available for suppliers selling goods through online platforms.

For example, a small and medium enterprise with a turnover of INR10 million selling ready-made garments can opt to pay 1% GST on offline sales. However, if they sell the same garments on an online platform, they would have to pay GST at 12%. This created disparity.

The budget 2023 proposals are aimed at eliminating this taxation imbalance between offline and e-commerce transactions. It is now proposed to allow composition dealers to sell

1. Indian E-commerce Industry Analysis | IBEF

goods through online platforms. The change will be from a date to be notified.

Furthermore, in the 47th GST Council meeting (29 June 2022) has also announced that unregistered persons will also be permitted to sell goods through e-commerce platforms. This change is yet to be implemented (and could be notified in sync with the change for composition dealers).

The Council also suggests that a mechanism would be set up to monitor turnovers of both categories of suppliers to ensure appropriate compliance with GST regulations. These are welcome changes. They will enable more sellers to reach wider set of customers.

At the same time, Budget also expects ecommerce platforms to particularly monitor sales by their unregistered and composition sellers. Certain penalties are proposed in cases where the seller was either over the limits prescribed or is making inter-state supplies despite being under composition. This will call for all platforms to "upgrade" their systems and processes to be able to capture this information and monitor it real-time.

In our view, as a part of the process of implementing the above provisions, the GST Council should address the following:

Tax Deducted at Source (TCS) and accumulation due to low rates	*Current TCS rate is 1% and manufacturer and trader under composition scheme is also required to pay tax on 1% on entire sales. This is different for regular sellers who may be paying 12-18% tax. Therefore, the need for accuracy and timeliness of reporting by platforms would be critical for composition sellers to offset such TCS against their monthly liabilities. Any gap in compliance by the platform may trigger a negative cash flow impact on the seller. Therefore, the Council may consider reducing the TCS rate to 0.1% or such similar lower rate (as the objective is only to track transactions).*
Access to data	*It is envisaged that TCS return would include reporting of PAN based turnover of unregistered supplier on the portal. GSTN could consider grant of access of such details to the online platforms for them to be able to discharge the obligations under the new penal provisions.*

B Expanding coverage of 'online' services

With increased usage of Information technology as a medium of provision of services, Budget 2023 has proposed to widen the scope of the existing definition of Online Information and Database Access or Retrieval ('OIDAR') services.

Under GST, overseas OIDAR services provider is liable to register and pay GST on transactions with persons not using the service for furtherance of business. For other cases, the receiving business is liable to pay GST under reverse charge principles. Furthermore, services that are "essentially automated and involving minimal human intervention" were covered in the scope.

Budget proposes to alter both these aspects. On the first one, the clause is proposed to be simplified to make the overseas provider liable in all cases where the buyer is unregistered for GST (instead of the vague term of use for furtherance of business). This should bring more certainty for such providers to determine transactions where they are liable to pay. GSTN provides data on registration status, which will be required to be captured by such providers to explain why taxes were not paid with respect to such buyers.

The second aspect is being amended to remove reference to the phrase quoted above. Therefore, once a service is provided "online", even if there is human intervention, it is likely to be covered in the expanded scope.

Budget 2023 changes may result in a two-fold impact - the former will require existing providers paying GST to realign their systems and processes to capture the right set of transactions on which GST should be paid. The latter would possibly bring in more service providers into the net, requiring them to register and comply with the GST provisions.

Budget 2023 **widens the scope of Tax Deducted at Source (TDS)**

- *Recent budgets have seen a widening of the withholding tax net, with the objective of fostering compliance, plugging leakages, and gathering data to enable analytics and intelligence.*
- *Budget 2023 continues this trend and introduces new proposals to extend withholding taxes requirement to more areas or to increase the amount of tax to be deducted/collected.*
- *Still, there are certain clarifications required in TDS related proposals.*

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Finance Bill, 2023 proposes to withdraw the current TDS exemption u/s 193 on interest payable to residents on listed debentures in dematerialized mode. The stated objective is to address the under-reporting of interest income by the recipient due to the TDS exemption. Such TDS is also proposed to apply to listed market-linked debentures, to be taxed as short-term capital asset at applicable rates, since the issuers of such instruments may regard the return on such instrument as interest.

TDS shall apply even if interest is credited to 'interest payable' or 'suspense account' in the book of accounts. This raises a challenge on the applicability of TDS on 'interest accrued but not due' credited in books, since the identity of the debenture holders to whom such interest will be ultimately paid on the coupon date may not be ascertainable.[1] Companies can rely on a Mumbai Tribunal ruling to defend non-applicability of TDS in such a case, but it would be desirable for the government to clarify the position to prevent unwarranted litigation.

All foreign remittances under Liberalized Remittance Scheme (LRS) except those related to education and medical treatment will be subject to enhanced

TCS of **20%** (with no threshold) instead of **5%** earlier that kicked in after a threshold of **INR7 lakhs**.

The decision to increase the TCS rate may be revisited and the objective of capturing transactions can be very well achieved even with a lower TCS

1. IDBI v. ITO (2007)(107 ITD 45)(Mum)

rate. The honest taxpayer, including the middle-class salary earner and senior citizens, will now need to shell out a larger amount of funds at the time of remittance. Also, in case the taxpayer has already paid advance tax or is sufficiently covered by TDS (like salaried employees), he will need to claim a refund for the excess TCS, which results in avoidable blockage of funds.

Remittances for education and medical treatment will continue to be governed by the current lower TCS of 5%[2] and INR7 lakhs threshold. However, Indians going abroad for education opportunities or medical treatment also bear other ancillary expenses, such as accommodation, food, living expenses and travel. Such expenses may be covered under 'educational or medical purposes'.

The increased TDS rate on overseas tour package may also impact the integrated domestic tour operators and the overall tourism industry.

These tours are taken by many aspirational middle-class taxpayers and senior citizens, who would now need to pay a higher amount upfront. The long wait till the filing of returns for getting refunds, if any, may deter them from opting for overseas tours. The government may clarify through explicit amendment or a Circular that the employer can consider such TCS for salary withholding purposes.

Taxation of any benefit or perquisite, whether convertible into money, arising from business or exercise of a profession, has been a subject of much debate after it was introduced last year. Some courts[3] have interpreted that if the benefit or perquisite are in cash, it is not covered within the scope of section 28(iv) of the Income tax Act. The government has now amended both sections 28(iv) and 194R to clarify that any benefit or perquisite granted in cash or in kind, partly or wholly, will be taxable.

While the amendment provides certainty on the issue, it may create a problem for the write-off of any trading debts or loans and advances. If TDS u/s 194R is applicable for the creditor writing-off the bad debts, it will lead to an additional burden for the creditor who, on one hand, cannot recover the amounts due and additionally, must deposit TDS from his account. CBDT has granted exemption[4] from TDS under section 194R for bad debts written-off, but only to certain categories of banks/ financial institutions in relation to loan settlements/waivers to borrowers. Other class of taxpayers may now face uncertainty and additional financial burden.

In this context, government should provide a carve-out for TDS on write-off of bad debts for all taxpayers since it cannot be considered as benefit or perquisite for the debtor. In many cases, the creditor may pursue the recovery of debt from debtor despite unilateral write off in its books. Also, if haircuts suffered by lenders in corporate insolvency process is considered as taxable benefit/ perquisite in hands of corporate debtor, it will adversely impact the resolution process. Appropriate clarification by government in this regard will provide certainty to the industry.

The move to widen the scope of TDS is understandable. However, the entire gamut of withholding taxes on domestic payments has become a complex maze that results in huge compliance burden for taxpayers. Along with the above suggested changes, going forward, government must provide a streamlined and rational framework for domestic withholding taxes.

2. 0.5% if the remittance is out of education loan borrowed from a qualifying financial institution
3. Notably, Supreme Court ruling in the case of CIT v. Mahindra & Mahindra Ltd (2018)(404 ITR 1)(SC)
4. FAQ 1 of Circular No. 18/2022

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Union Budget 2023
strict clauses continue to challenge charitable institutions

- *Charitable institutions have faced many complexities due to amendments in the Income Tax Act in the past many years.*
- *A recent amendment is likely to restrict their ability to incur large capital expenditure.*
- *While the income of charitable institutions registered under the Income Tax Act continue to remain exempt from taxes, the process for availing such exemption is now subject to review and intense scrutiny by tax authorities.*

The past few years witnessed a complete overhaul in the tax regime for charitable institutions be it under the income-tax laws or foreign contribution regulation law. While the income of charitable institutions registered under the Income Tax Act continue to remain exempt from taxes, the process for availing such exemption is now subject to review and intense scrutiny by tax authorities. While the intention is said to ensure allowance of exemption to deserving institutions and avoiding misuse of beneficial provisions, increased complexity in administration and compliances of charitable institutions severely impacted small charities.

Two recent Supreme Court rulings in the case of New Noble and AUDA further unsettled the well-established interpretation of tax laws adding to the agony of charitable institutions by impacting their ability of fundraising, self-sustainability and tax exemption.

Charitable institutions were eagerly awaiting Union Budget 2023 in anticipation of some clarification to soften the effects of these Supreme Court rulings. The Union Budget 2023, however, stopped short of providing any relief to charitable institutions, both from a tax exemption and compliance perspective.

Currently, when a charitable institution receives grant and donates 85% of such grant to another charity, it is entitled to claim 100% of the grant as tax exempt.

However, the law would now require charitable institutions to donate 100% of the grant amount to other charities in order to avail full tax exemption. This amendment is said to be made to plug a so-called loophole arising from chain donations where each donating charitable institution can claim 15% of deemed tax exemption. Misuse of provision by a few, has led to increased obligation for all charities.

The Income-tax Act provides that when an amount is spent out of corpus, the same would be allowed as application only upon recoupment of corpus. Also, in case of loans, repayment of loans would be allowed as application in the year of repayment. Currently, the law does not provide for any time-limit for such recoupment / repayment. Now, a new amendment is proposed allowing application only where recoupment of corpus or repayment of loans is completed within a period of 5 years. This may restrict the ability of charitable institutions to incur large capital expenditure, where the returns would flow in after a few years.

Charitable institutions that have already initiated their activities are now allowed to apply for final tax exemption registration directly instead of a provisional one. While this is a welcome amendment, Principal Commissioner / Commissioner of Income-tax are now empowered to examine the objects, genuineness of activities and past compliances of the institutions before granting registrations.

Charities are exposed to the provisions of 'exit tax' and are liable to pay tax at

34.94%

on the accreted income (FMV of assets less FMV of liabilities) upon violation of certain conditions (viz. conversion into non-charity form, transferring assets to any non-charitable entity, merger with entity not having similar objects etc). Now, in addition to these conditions, if there is a delay in filing of application for registration / re-registration for tax exemption, it would be deemed that the charitable institutions have been converted into non-charitable form, thereby triggering exit tax implications. This is an unrelenting amendment and would put additional pressure on charitable institutions from an administration and compliance standpoint.

Charitable institutions are required to apply 85% of their income every year to claim tax exemption.

In a year where they fall short of 85% application, they are allowed to carry forward the balance to subsequent years for application. The law requires institutions to intimate tax authorities (in prescribed form) about such accumulation before the due date of filing of tax return. The timeline of filing this form has been preponed by two months (i.e. one month ahead of due date of audit). This amendment would be difficult to execute since in the absence of completion of audit, charities would struggle to finalize their numbers and determine the amount for which intimation is required to be made to the tax authorities in a time-bound manner.

If there is a single day of delay in filing of tax returns beyond statutory due dates, charitable institutions will lose their tax exemption. Many may consider this amendment to be very rigid and strict, and would expect institutions to tightly follow compliance timelines to miss out on tax exemption.

With constant changes in the tax laws and ever evolving jurisprudence, charitable institutions are expected to be more vigilant about their activities, compliances and governance than ever before. While the government is aiming to bring parity between different schemes of exemption for charitable institutions under the income tax Act, it is only adding complexity in charity administration and taxation. The need of the hour is clearly having a uniform tax regime which should not only be easy to follow but also help avoid misinterpretation and reduce litigation.

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