STREAMLINING DIRECT AND INDIRECT TAXATION

Boosting Ease of Doing Business in AatmaNirbhar Bharat

SMAHI

August 2021

ABOUT SMAHI FOUNDATION OF POLICY AND RESEARCH

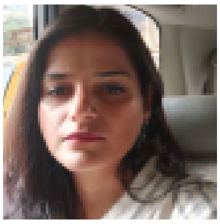
Smahi Foundation of Policy and Research is a non-profit organization based in Bengaluru. The word Smahi stands for progress. Smahi Foundation of Policy and Research (Smahi) works towards forward-looking policy making and harmonization of stakeholder views on issues of public policy to lead India towards progress. We focus on technology-led solutions to spur creation of stronger public digital infrastructure.

AUTHORS

ARJUN SK

Research Consultant, Smahi

Arjun is a chartered accountant with more than 10 years experience in tax with a special focus on mergers and acquisitions. As a director with Ernst and Young, he has advised various international and domestic clients among other things on key strategic initiatives, acquisitions, divestments, fund raises, restructurings, promoter/ employee compensation planning and policy initiatives.



RITU BHANDARI

Head of Research, Smahi

Ritu is a Chartered Accountant and Chartered Financial Analyst, with extensive experience in the banking industry. She is located in Mumbai and tweets at @Ritu_twt

SUSHRUT CHITALE

Chartered Accountant

Sushrut is a Partner with Mukund M Chitale & Co, Chartered Accountants and leads the consulting division at the Firm. He is an elected member to the Western India Regional Council of the ICAI and has served as a Secretary to the Regional Council.

NIMISH JOSHI

Director, Smahi

Nimish Joshi is an engineer and MBA, with experience in conceptualizing, funding, and scaling technology businesses.

https://twitter.com/SmahiFoundation

Contact Us : +91 98208 38450 / smahifoundation@gmail.com

CONTENTS

INDIRECT TAXES

EXECUTIVE SUMMARY

Taxation is a critical area for the government – business interface in the economy. Tax levels as well as administration have an important influence on how the larger economy works. Tax administration should ideally be outcome of the business activity and not an activity in itself. From the era of stringent government controls, which also defined the tax administration philosophy, India has travelled a long distance on business reforms. But the tax administration has a dual catching up to do – keeping in step with the best practices on taxation globally without compromising the fiscal space and ensuring that simplification is commensurate with the larger economic reforms.

This twin challenge along with the fiscal constraint requires constant relook at rules and procedures and an agile approach towards tax management. In the last published Ease of Doing Business report by the **World Bank for 2020,** India ranked **63,** up 14 places from the prior year and long past the 134th rank in 2014. **However, among 190 nations, on the parameter of 'Paying taxes', India still had a rather low ranking of 115.** This ranking reflected a combination of measures like ease of tax payments, time required for tax compliance, total tax and contribution rate for a firm. Taxation reforms have historically thus been a lagging area when it comes to larger economic changes.

India requires a straight-forward and simple rule based tax structure, which creates an environment where new entrants with drive and innovative ideas can easily get started in business and flourish. The tax administration should enable productive firms to invest, expand and create new jobs. **Active steps should be taken to issue clarifications and rationalise legislation to address ambiguities in the law.**

'Ease of collecting tax' should not become a contradiction to 'ease of doing business'. This macro view requires greater co-ordination among various Finance Ministry departments as well as regulators.

Use of technology to simplify procedures while preventing leakages is critical. There is a need to create level playing field in several areas.

The tax treatment for online and offline commerce is one example where improvements are possible. How various investment vehicles are taxed for investments in the same asset class is another area where further reform is possible. With the Covid-19 pandemic still causing economic disruptions in August 2021 at the time of writing this report, tax policies can also encourage socially responsible corporate behaviour by encouraging targeted CSR spends.

The Goods and Services Tax (GST), enacted in 2017, is still in its early years. A lot of ground work has been done to get it implemented. The GST digital compliance and tax administration framework is unprecedented in its scale and ambit.

In the past four years, while the reform has come-of-age, the GST structure needs to be re-looked and re-balanced to deal with specific challenges and issues based on new experiences and learnings.

This is the time to ensure that the law continues to contribute to the economic well-being of the society and country at large.

The nationwide roll-out of a GST system in 2017, implementation of an effective Insolvency & bankruptcy code in 2018 and a large 8-15 percent cut in corporate income-taxes in 2019 have helped businesses. On the back of **multiple reforms by the government** such as labour reforms, agriculture reforms (though stalled), Production Linked Scheme (PLI), further tax administration simplification can help India on the path to a $5 trillion economy.

DIRECT TAXES

1. PARITY

SNAPSHOT

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
1	Section 9 - Applicability of indirect transfer provisions to multi layered overseas funds	The benefit accorded to non-residents who have invested indirectly in specific funds can also be extended to other overseas funds that invest directly into India. Some illustrative conditions to extend this benefit could be: ◆ Investors in the fund may not be subject to Indian capital gains tax when the overseas fund is subject to capital gains tax in India (i.e. one level tax) ◆ Entities which are registered under fund regimes of overseas jurisdiction or are registered under a new and separate Indian regime (which could be handled by SEBI or CBDT) could be provided with this benefit (similar to registrations for Category I and II FPIs). ◆ In either of the above scenarios, additional safeguards such as minimum number of investors, investors not being related parties or part of the same group, minimum corpus etc. may be specified to ensure that the benefit is granted to genuine funds.
2	Section 72A - Transition of losses on mergers and corporate reorganisations	◆ Provide greater flexibility to businesses which are not engaged in any of the prescribed activities to transition (carried forward/ set-off) losses as part of an amalgamation/ merger at par with demerger (Prescribed activities such as the manufacture or processing of goods/ computer software, generation or distribution of electricity or any other form of power, providing telecommunication services, mining, construction of ships, aircrafts or rail systems)
3	Rationalisation of capital gains tax rate on sale of shares by residents	◆ In order to give incentive to domestic investors, the long term capital gains tax rate for residents on sale of unlisted shares can be reduced to 10 per cent (to maintain parity with the rate applicable to non-resident corporates)

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
4	Rationalisation of income-tax rate for LLPs and partnership firm	◆ Extend the benefit of lower income tax rates to firms and LLPs as well. ◆ A threshold limit, say turnover of below Rs 10 crore, could be considered
5	Allow registered valuers to issue valuation reports under premium tax provisions	◆ Taxpayers to be given the option to obtain valuation reports from valuers registered under the companies act (i.e. registered valuers'), considering the cost involved in obtaining valuation reports from merchant bankers

1 Section 9 - Applicability of indirect transfer provisions to multi layered overseas funds

POLICY RECOMMENDATION

The benefit accorded to non-residents who have invested indirectly in specific funds can also be extended to other overseas funds that invest directly into India. Some illustrative conditions to extend this benefit could be:

- Investors in the fund may not be subject to Indian capital gains tax when the overseas fund is subject to capital gains tax in India (i.e. one level tax)
- Entities which are registered under fund regimes of overseas jurisdiction or are registered under a new and separate Indian regime (which could be handled by SEBI or CBDT) could be provided with this benefit (similar to registrations for Category I and II FPIs).
- In either of the above scenarios, additional safeguards such as minimum number of investors, investors not being related parties or part of the same group, minimum corpus etc. may be specified to ensure that the benefit is granted to genuine funds.

DESCRIPTION

Transfer of shares or interest in an overseas entity when such overseas entity derives substantial value (i.e. >50 per cent) from assets/ property located in India is subject to tax in India.

RATIONALE

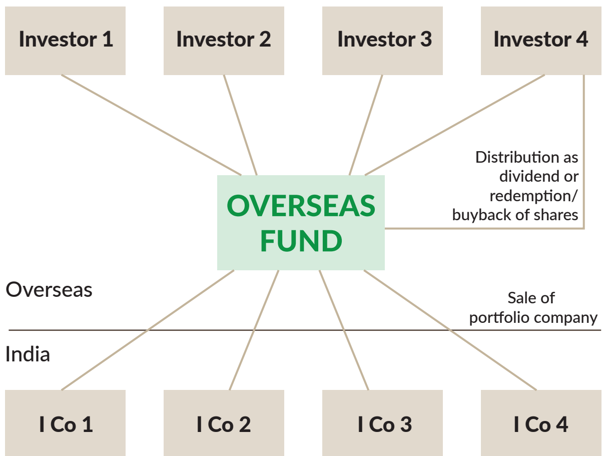
Overseas funds typically invest into India through an overseas pooling vehicle. This vehicle is essentially a feeder entity whose shares are acquired by investors across the globe. Such funds may have both India and overseas investments and distributions by such funds to their investors are based on sale of portfolio companies/ exit events which happen at different points in time.

When an overseas fund sells shares in an Indian company, in most cases the fund ends up paying capital gains tax in India. Consequently, when such funds distribute these proceeds to its investors by way of redemption of shares or buyback of shares, the investors are also subject to capital gains tax in India.

To avoid this, the CBDT has issued a circular (Circular 17 of 2017) stating that such provisions would not apply to cases where a non-resident receives income on redemption/ buyback of shares or interest held indirectly in certain specified funds (such as Category I AIFs, VCFs etc.) provided that

(A) such income accrues or arises in consequence of transfer of shares or securities held in India by the specified funds and such income is chargeable to tax in India and

(B) The amount distributed does not exceed the pro-rata share of the investor from the divestment.



- Overseas Fund has collected monies from a number of investors across the globe
- Overseas Fund has invested in a number of Indian companies and derives all its value from India

TRANSACTION AND IMPACT

- Overseas Fund has sold shares of I Co 4 and has paid capital gains tax
- Overseas Fund distributes net sales amount to all its investors as either:

(A) Dividends - no tax in such cases due to specific circular

(B) Redemption or buyback of shares - Investors to pay capital gains tax again in India

RELEVANT REGULATION

Income Tax Act, 1961

2 Section 72A - Transition of losses on mergers and corporate reorganisations

POLICY RECOMMENDATION

- Provide greater flexibility to businesses which are not engaged in any of the prescribed activities to transition (carried forward/ set-off) losses as part of an amalgamation/ merger at par with demerger

  (Prescribed activities such as the manufacture or processing of goods/ computer software, generation or distribution of electricity or any other form of power, providing telecommunication services, mining, construction of ships, aircrafts or rail systems)

DESCRIPTION

As per the current provisions, in case of merger of two companies, accumulated tax business losses and unabsorbed depreciation of the amalgamating company can be carried forward and set-off by the amalgamated/ surviving company only when the amalgamating company owns an 'industrial undertaking' (among other conditions).

An industrial undertaking has been defined as one which is engaged in activities such as the manufacture or processing of goods/ computer software, generation or distribution of electricity or any other form of power, providing telecommunication services, mining, construction of ships, aircrafts or rail systems

BRIEF HISTORY

While the section has been amended several times since its introduction, the condition with respect to 'industrial undertaking' has been present ever since the section was introduced in 1977.

The original intent was to provide incentives and remove impediments related to takeover of sick industrial units by sound industrial units and relieve the government of taking over and turning around such sick units.

RATIONALE

Interestingly, this condition is absent in case of transition of losses through a demerger of a business/ undertaking. Consequently, in cases where commercial/ regulatory considerations necessarily require an amalgamation/ merger, there is usually a lapse of past tax losses.

Considering the current economic situation, removing this condition would go a long way to help businesses consolidate in a much more effective and efficient manner

The proposed amendment would greatly help new age businesses to consolidate their businesses in a much more efficient manner and availability of losses may help them raise funds more efficiently.

RELEVANT REGULATION

Income Tax Act, 1961

3 Rationalisation of capital gains tax rate on sale of shares by residents

POLICY RECOMMENDATION

- In order to give incentive to domestic investors, the long term capital gains tax rate for residents on sale of unlisted shares can be reduced to 10 per cent (to maintain parity with the rate applicable to non-resident corporates)

RATIONALE

Currently, non-resident corporates are entitled to a beneficial long term capital gains tax rate of 10 per cent on sale of both listed and unlisted shares.

Residents are subject to 10 per cent tax on sale of listed shares which are long term in nature and a higher rate of 20 per cent on unlisted shares (which can be as high as ~28 per cent after including surcharge and cess)

RELEVANT REGULATION

Income Tax Act, 1961

4 Rationalisation of income-tax rate for LLPs and partnership firm

POLICY RECOMMENDATION

- **Extend the benefit of lower income tax rates to firms and LLPs as well.**
- **A threshold limit, say turnover of below Rs 10 crore, could be considered**

BRIEF HISTORY

Over the past 3-4 years, in line with its commitment to lower corporate income tax rates, the government has reduced the rate from a high of 30 per cent for companies. Currently, domestic companies are subject to tax rates ranging from 15 per cent to 25 per cent.

RATIONALE

While this has certainly helped corporates, there is an ask from small businesses and professionals (who conduct business through non-corporate entities like firms and LLPs) that such a benefit should be extended to them as well. Further, a number of professionals are required by their professional bodies to necessarily conduct business either as sole proprietors or firms/ LLPs.

RELEVANT REGULATION

Income Tax Act, 1961

5 Allow registered valuers to issue valuation reports under premium tax provisions

POLICY RECOMMENDATION

- Taxpayers to be given the option to obtain valuation reports from valuers registered under the companies act (i.e. registered valuers'), considering the cost involved in obtaining valuation reports from merchant bankers

BRIEF HISTORY

Prior to 2018, taxpayers were allowed to obtain valuation reports from merchant bankers or accountants.

RATIONALE

As per Section 56(2)(viib) read with Rule 11UA and 11U, for the purposes of justifying the fair value of unquoted equity shares, a taxpayer is either required to follow the prescribed formula in the rule or obtain a report from a SEBI registered category I merchant banker.

Representations have been received from a number of small businesses that the cost involved in obtaining a report from such bankers is very high. Interestingly for the purpose of Section 50CA, taxpayers are allowed to obtain valuation reports from either merchant bankers or accountants.

RELEVANT REGULATION

Income Tax Act, 1961

2. CASHFLOW

SNAPSHOT

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
6	Section 50CA; Capital gains payable on difference between transaction/ transfer value and prescribed fair value of unquoted shares	◆ The taxpayer must be given an option to consider either the book value or the actual fair value (backed by a valuation report issued by merchant banker/ accountant) for computing capital gains for the purpose of section 50CA.
7	Section 56(2)(x) - Gift tax	◆ Give taxpayer an option to consider 'book value' or actual fair value for equity shares. ◆ For listed shares, fair value/ quoted price to be considered as the trading price of the shares on the date when definitive agreements to acquire shares were first entered into (and not actual date of transfer).
8	Section 56(2)(viib) Premium Tax	◆ To provide a specific carve-out for restructuring transactions such as court approved mergers, demergers, business transfers and other reconstructions.
9	Swap of Shares	◆ Exempt share swap transactions and require sellers to pay tax only when cash is realised on subsequent sale. The period of holding and the cost of such exchanged shares can relate back to the original shares ensuring no loss to the revenue ◆ Since the transaction would be 'exempt', the sellers should compulsorily report such share swap transactions in the return of income for the relevant financial year

6 Section 50CA; Capital gains payable on difference between transaction/ transfer value and prescribed fair value of unquoted shares

POLICY RECOMMENDATION

- The taxpayer must be given an option to consider either the book value or the actual fair value (backed by a valuation report issued by merchant banker/ accountant) for computing capital gains for the purpose of section 50CA.

DESCRIPTION

The prescribed fair value for different classes of shares are as follows:

- Equity shares - Formula prescribed that essentially results in computation of 'book value' of such equity shares
- Preference shares - price it would fetch in the open market (i.e. actual fair value)

The prescribed formula for computing value of equity shares requires exclusion of reserves and surplus by whatever name called (which includes such securities/ share premium) from the definition of 'liabilities' (thereby increasing the net asset value i.e. numerator) but considers only the number of equity shares (in the denominator) to arrive at the per share value.

This leads to cases where the actual fair value of shares is significantly lower than the book value of such equity shares, leading to undue hardship to Indian founders/ employees, who are required to pay additional capital gains tax.

In summary, the formula prescribed may not be reflective of the actual fair value of equity shares since there are a number of cases and real-life scenarios where the actual fair value would be significantly lesser than the book value/ prescribed value.

In order to remove this hardship, the amendment is proposed. Such flexibility is already available to taxpayers for the purpose of determining/ defending premium tax under section 56(2)(viib) read with rule 11UA(2)

RATIONALE

The mechanism to compute fair value of equity shares results in a number of practical challenges. Typically, sophisticated investors invest in preference shares and such preference shares are issued at high premiums, whereas founders/ promoters/ employees of the company hold equity shares.

ILLUSTRATION (50CA):

Consider the following table wherein Mr A has subscribed to 10 equity shares at Rs 10 each and an investor has subscribed to 100 preference shares at Rs 100 each with face value of Rs 10 and a premium of Rs 90.

Particulars	Reference	Number of shares	Amount (in Rs)
Equity Share Capital	A	10 at Rs 10 per share	100
Preference Share Capital	B	100 at face value of Rs 10	1,000
Securities Premium	C	Rs 90 per preference share	9,000
Total of liabilities	**A+B+C**		**10,100**
Cash	D		10,100

(Based on the formula prescribed, the fair value of each equity share would be:
(10,100 -100) *10/ 100 = Rs 1,000 per share

This goes against the grain of normal commercial principles, since the equity share-holder in the instant case would have been entitled to ~9.09 per cent of the actual fair value of the company and correspondingly received ~ Rs 918 on a 100% sale of the company. While this is a simplistic example, it is very much possible that in the case of companies which have huge balances in securities premiums accounts and also have significant operating losses (both of which need to be excluded from liabilities), the actual fair value of their unlisted equity shares would be significantly lower than the prescribed fair value/ book value.

RELEVANT REGULATION

Income Tax Act, 1961

7 Section 56(2)(x) - Gift tax

POLICY RECOMMENDATION

- Give taxpayer an option to consider 'book value' or actual fair value for equity shares.
- For listed shares, fair value/ quoted price to be considered as the trading price of the shares on the date when definitive agreements to acquire shares were first entered into (and not actual date of transfer).

DESCRIPTION

When a buyer purchases quoted or unquoted shares at a price which is lesser than the prescribed fair value of such shares, the difference is treated as 'income from other sources' and subject to income-tax.

Prescribed fair value for unquoted shares - same as discussed for section 50 CA

Prescribed fair value for listed/ quoted shares:

- When transaction is carried out on stock exchange - fair value is the transaction value recorded on the stock exchange
- Transaction not carried out on stock exchange - lowest price quoted on any stock exchange on either a) date of transfer or b) when no trading occurred on date of transfer, a date immediately preceding the transfer date when trading took place

RATIONALE

For unlisted equity shares - Similar to the issued discussed for section 50CA regarding difference between actual fair value and 'book value' of equity shares

For listed shares - There are cases wherein the price for acquisition of listed company shares is agreed upfront, but due to regulatory requirements (such as open offer requirements under SEBI takeover code, exchange control requirements, CCI approvals etc), the shares are actually transferred at a later date, once such approvals are obtained or processes are completed.

Furthermore, due to certain limitations in securities laws and exchange control regulations, not all acquisition transactions are necessarily carried out on the stock exchange.

Since there is a time gap between the date of agreement to acquire shares and the date of actual acquisition of shares, any increase in the listed/ trading price of shares would subject the buyer to gift tax. Thus, in such cases, the buyer is subject to gift tax provisions for reasons beyond his control.

RELEVANT REGULATION

Income Tax Act, 1961

8 Section 56(2)(viib) Premium Tax

POLICY RECOMMENDATION

- To provide a specific carve-out for restructuring transactions such as court approved mergers, demergers, business transfers and other reconstructions.

DESCRIPTION

Where an unlisted company receives consideration on issue of shares from an Indian resident, then any excess amount received over and above the fair value (And face value) of the shares is taxed as income from other sources in the hands of the recipient company.

Fair value of shares maybe as per prescribed formula or valuation report issued by merchant bankers

RATIONALE

While the section was primarily introduced as a measure to deter the generation and use of unaccounted money, the provision also applies to genuine transactions which do not involve issue of shares for cash consideration as (for e.g. court/tribunal approved mergers, demergers etc.)

RELEVANT REGULATION

Income Tax Act, 1961

9 Swap of Shares

POLICY RECOMMENDATION

- Exempt share swap transactions and require sellers to pay tax only when cash is realised on subsequent sale. The period of holding and the cost of such exchanged shares can relate back to the original shares ensuring no loss to the revenue
- Since the transaction would be 'exempt', the sellers should compulsorily report such share swap transactions in the return of income for the relevant financial year

DESCRIPTION

As per the current definition of the term 'transfer', an exchange of assets is also covered and thus a swap of shares would also trigger capital gains tax liability in the hands of the sellers.

RATIONALE

In case of share swaps, the sellers are required to pay capital gains tax even though they have not realised any cash. This leads to a liquidity crunch for such sellers.

A number of consolidation deals (especially in the start-up space) are in the nature of a share swap and the sellers do not realise any cash until a final exit event, which may not take place in the near future.

Share swaps are not taxable in the USA and UK (subject to conditions) and tax is usually payable when the shareholder finally receives cash.

ILLUSTRATION

Mr A, an Indian resident, holds shares in an Indian company, ABC Pvt Ltd.

XYZ Pvt Ltd intends to acquire 100 per cent stake in ABC for Rs 100 Crore where Rs 5 Crore would be paid in cash and the balance Rs 95 Crore would be discharged by issuing shares of XYZ to Mr A.

In this situation, Mr A would have a total capital gains tax liability of ~ Rs 28 crore whereas he has received cash of only Rs 5 Crore as part of the deal

If share swaps were exempt as proposed, then Mr A would have had to pay capital gains tax on Rs 5 crore upfront (for which he has ample cash), whereas tax on Rs 95 crore would be paid in the future when he finally sells shares of XYZ Pvt Ltd.

RELEVANT REGULATION

Income Tax Act, 1961

3. REVISION WITH TIME

SNAPSHOT

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
10	Section 54EC - Capital gains relief on investment in government bonds	◆ In order to mobilise funds, the government could look at increasing the limit of Rs 50 lakh to say Rs 1 crore or more. ◆ A lock- in for a longer duration than the current duration of 5 years may be considered
11	Section 71(3A) - Limit on deduction of interest on home loans for self-occupied property	**Option 1:** ◆ Limit of Rs 2 lakh to be removed altogether **Option 2:** ◆ Separate limits can be introduced for metro and non-metro cities - considering that the cost of real estate and housing is higher in such cities. A similar concession has been made for determining the quantum of house rent allowance in Rule 2A of the Income-tax Rules, 1962 **Option 3:** ◆ The amount of interest deduction may be capped with reference to the interest amount - say 50-75 per cent of interest paid in a year maybe allowable as a deduction The exact mechanism/ option should be selected after analysing the current trends in the real estate sector and undertaking a cost-benefit analysis vis-a-vis loss of tax revenue and overall economic impact of the concession.

10 Section 54EC - Capital gains relief on investment in government bonds

POLICY RECOMMENDATION

- In order to mobilise funds, the government could look at increasing the limit of Rs 50 lakh to say Rs 1 crore or more.
- A lock- in for a longer duration than the current duration of 5 years may be considered

DESCRIPTION

As per the current provisions, long term capital gains arising on sale of a building or land (or both) is reduced by the proportionate amount invested by the sellers in government bonds (issued by NHAI or RECL). The amount of such investment has been capped at Rs 50 lakh per year for each taxpayer.

BRIEF HISTORY/ RATIONALE

It is noteworthy that this limit of Rs 50 lakh was introduced by the Finance Act 2014 and has remained the same since then. It is only fair to revise the limit with passage of time.

RELEVANT REGULATION

Income Tax Act, 1961

11 Section 71(3A) - Limit on deduction of interest on home loans for self-occupied property

POLICY RECOMMENDATION

- **Option 1:**
  Limit of Rs 2 lakh to be removed altogether
- **Option 2:**
  Separate limits can be introduced for metro and non-metro cities - considering that the cost of real estate and housing is higher in such cities. A similar concession has been made for determining the quantum of house rent allowance in Rule 2A of the Income-tax Rules, 1962
- **Option 3:**
  The amount of interest deduction may be capped with reference to the interest amount - say 50-75 per cent of interest paid in a year maybe allowable as a deduction

The exact mechanism/ option should be selected after analysing the current trends in the real estate sector and undertaking a cost-benefit analysis vis-a-vis loss of tax revenue and overall economic impact of the concession

BRIEF HISTORY

The provision was introduced in 2017 and limits the deduction of loss under the head house property to Rs 2 lakh.

BRIEF HISTORY

Essentially, an individual who has availed a home loan and has an interest cost of > Rs 2 lakh cannot deduct such interest costs from his other sources of income (say salary income) of the excess amount.

Keeping in mind the current economic climate and the need to spur consumption, the proposed alternatives can be considered.

RELEVANT REGULATION

Income Tax Act, 1961

4. Ease of Doing Business (EoDB)

SNAPSHOT

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
12	Section 194O; TDS of 1 per cent by E-Commerce Sites	◆ Either TDS u/s of Income Tax Act or TCS u/s 52 of CGST Act should be levied, not both. ◆ There should be greater co-ordination between Income Tax and GST departments to track the tax payer. **Option 1:** ◆ Scrap section 194O **Option 2:** ◆ Extend the benefit of 'no TDS on GST component' to sale of goods as well to achieve parity with services through e-commerce sites ◆ Explicitly clarify that TDS is applicable only on the sale price component and not on other amounts charged by e-commerce operator (e.g. transportation charges) to the end customers
13	Date of balance sheet for the purpose of section 56(2)(x)	**Option 1** ◆ Allow use of last adopted or last audited balance sheet to determine fair value of unlisted equity shares **Option 2** ◆ Provide flexibility by allowing taxpayers to use un-audited or management accounts.
14	Remove matching system for TDS credit	◆ Allow credit of TDS in the year of deduction itself and not require matching of TDS with the year of accrual of income.

12 Section 194O; TDS of 1 per cent by E-Commerce Sites

POLICY RECOMMENDATION

- Either TDS u/s of Income Tax Act or TCS u/s 52 of CGST Act should be levied, not both.
- There should be greater co-ordination between Income Tax and GST departments to track the tax payer.

Option 1:

- Scrap section 194O

Option 2:

- Extend the benefit of 'no TDS on GST component' to sale of goods as well to achieve parity with services through e-commerce sites
- Explicitly clarify that TDS is applicable only on the sale price component and not on other amounts charged by e-commerce operator (e.g. transportation charges) to the end customers

BRIEF HISTORY

The purpose of this section is to widen the TDS base by bringing e-Commerce participants under the tax net.

The new Section 194-0 was introduced in the Union Budget, 2020 and has come into force from October 1 2020. With the increase in e-commerce sales, there has been a drastic increase in the number of sellers who sell goods and services through e-commerce platforms.

Earlier, there was no tax deduction on payments made to e-Commerce participants. They were required to independently file their income tax returns. Therefore, many small e-Commerce participants didn't file their income tax returns and escaped the tax liability.

RATIONALE

For Option 1:
The e-commerce companies are already collecting TCS at the rate of 1 per cent under section 52 of the CGST Act. Already the data of the goods/ service provider is captured through the GSTIN and hence better sharing of data between the income-tax and indirect tax departments can help in identifying taxpayers who are in the tax net (i.e. separate levys under different laws may not be required)

The introduction of section 194O introduces an additional administrative burden in case of certain providers. Also, many platform workers work on a cash basis and it is difficult for platforms to manage this 1 per cent TDS procedure.

Further, since TDS provisions attract monetary as well as penal consequences, a number of e-commerce operators are deducting taxes irrespective of the income-levels of the service providers, since it is very difficult for the e-commerce operators to actually check the income of each and every service provider to determine if their income is below the Rs 5 lakh bracket.

Most of the platform workers also don't fall under the tax bracket and they do not have the wherewithal to engage with a Chartered Accountant to claim tax refund. Thus they end up losing their hard-earned money

For Option 2:

Section 194O requires e-commerce players to deduct TDS of 1 per cent on 'gross amount' of payments made to vendors for sale of goods or services through the e-commerce platform.

CBDT has clarified vide Circular No 23/2017 dated July 19 2017 that TDS is not required on 'GST component' when such GST has been separately indicated in the invoice and such GST pertains to 'services'. Thus currently, TDS applies on GST component pertaining to sale of goods but not on services. We need to bring parity.

The other amounts paid by the customer (say transportation charges etc.) to e-commerce platform (which are connected to the sale of goods or services) may come within the ambit of 'gross amount' and thus it should be clarified that such charges which the e-commerce operator collects on his own account should be excluded for the purpose of this section.

ILLUSTRATION 1 (1940)

- Aggregate Sales from Ramesh to Chaitanya through Amazon: Rs 7,08,000
- GST @ 18% included in the above sales = Rs 108,000
- Commission @ 6% charged by Amazon included in above sales = Rs. 42,480

Therefore;

- Amazon India is the e-Commerce Operator and Ramesh is the e-commerce Seller.
- Since the aggregate sales surpass Rs 5,00,000 and Ramesh is an Indian resident, the e-commerce operator i.e. Amazon is liable to deduct TDS @ 1% on aggregate sales before making payment Ramesh.
- TDS = 1% of 7,08,000 = Rs. 7,080
- Payment to Ramesh = 7,08,000 – 42,480 – 7,080 = 658,440
- The ecommerce operator shall deposit TDS of Rs 7,080 with the IT department and also file Form 26Q.
- If Ramesh did not have Aadhar or PAN, then TDS @ 5% shall be deducted regardless of the aggregate sales amount.

As per proposed recommendation in Option 2, the TDS should only be on net sales of Rs 600,000 and TDS amount should be Rs 6,000 and not Rs 7,080.

ILLUSTRATION 2 (1940)

- Suresh needed AC repair services and therefore he requested for a technician from Urban Company at a fixed charge of Rs 5,000.
- The technician realised that some basic parts in the AC need to be replaced and therefore Suresh had to pay additional Rs 2,000 for the parts and other consumables used by the technician in cash.

Therefore:

- Urban Clap deducted TDS @1% on Rs 5,000 and deposited the same within the due date. However, tax was not withheld on Rs 2,000 as Urban Company was not aware about the spare parts transaction.
- Considering the letter of the law, payments made by customers to vendors/ e-commerce participants directly are deemed to be payments made by e-commerce sites to such e-commerce participants/ vendors and included in the term 'gross amounts'.
- In such scenarios, there would be non-compliance with withholding tax provisions and Urban Company will have to bear the cost of such non-compliances. Considering the complexity of e-commerce business models, potential litigation cannot be ruled out and clarity must be provided.

RELEVANT REGULATION

Income Tax Act, 1961; The Central Goods and Services Act, 2017

13 Date of balance sheet for the purpose of section 56(2)(x)

POLICY RECOMMENDATION

- Date of balance sheet for the purpose of section 56(2)(x)

  Option 1
- Allow use of last adopted or last audited balance sheet to determine fair value of unlisted equity shares

  Option 2
- Provide flexibility by allowing taxpayers to use un-audited or management accounts.

RATIONALE

As per section 56 read with Rules 11UA and 11U, the method to determine fair market value of unlisted equity shares requires the taxpayer to use an audited balance sheet as on the date of transfer of such equity shares.

A number of representations have been received that such a method is difficult and cumbersome, since drawing up a balance sheet and auditing the same is a very difficult and time-consuming activity. Most private companies are required to get their accounts audited on an annual basis and repeating the process for tax purposes alone is not feasible.

RELEVANT REGULATION

Income Tax Act, 1961

14 Remove matching system for TDS credit

POLICY RECOMMENDATION

- Allow credit of TDS in the year of deduction itself and not require matching of TDS with the year of accrual of income.

RATIONALE

This would also ensure that refund of TDS on advance payments are received by the taxpayer as soon as possible, rather than in subsequent years when the income is actually taxable.

As per Rule 37BA, credit for tax deducted at source and paid to the government is allowed in the year in which income is assessable

While the current income-tax returns do provide taxpayers with the ability to claim TDS credit in subsequent years, allowing taxpayers to claim credit in the year of deduction itself (as appearing in form 26AS for a particular financial year) will ease compliance burden and costs.

ILLUSTRATION

This 'matching concept' creates practical issues in a number of situations such as when income accrues in Year 1, but the payee has recorded the expense in his books only in Year 2 and payment (after deduction of TDS) is received in Year 2 after due date of filing return. In such a scenario, the taxpayer is denied credit in the year of accrual of income .

Another situation could be when advance has been received (after deduction of TDS) in Year 1 but the income accrues in Year 2, the taxpayer has to perform a number of reconciliations to arrive at the TDS credit that he would be entitled to claim in Year 2.

RELEVANT REGULATION

Income Tax Act, 1961

5. MISCELLANEOUS

SNAPSHOT

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
15	Section 37 –CSR activities is not tax deductible	◆ Allow deduction for expenses on CSR activities undertaken by corporates. ◆ The amount of deduction can be capped to the minimum amount prescribed by the Companies Act
16	Category III AIFs post 2019 are not considered as a pass through and are taxed at investor's slab.	◆ As in case of capital gain, AIF is considered as only the pass through entity and the gains are taxed in the hands of investor, the same treatment should also be considered for gain arising to AIF for participating in Commodity Derivatives. OR ◆ The maximum rate of tax should not be more than individual's maximum marginal rate.

15 Section 37 –CSR activities is not tax deductible

POLICY RECOMMENDATION

- **Allow deduction for expenses on CSR activities undertaken by corporates.**
- **The amount of deduction can be capped to the minimum amount prescribed by the Companies Act**

DESCRIPTION

Section 37 of the IT Act is a residuary provision on deductions. It permits any business expenditure to be availed as deduction, provided the expense

(a) cannot be claimed as deduction under sections 30 to 36,

(b) is of revenue nature and

(c) has been expended wholly and exclusively for the purposes of business or profession, i.e. is not of personal nature. Rule 4(1) clarifies that for the purposes of section 135, CSR expenditure shall not include an expenditure incurred on activities undertaken in the normal course of company's business.

The Act requires companies with a net worth of Rs 500 crore or more, or turnover of Rs 1,000 crore or more, or a net profit of Rs 5 crore or more during the immediately preceding financial year, to spend 2 per cent of the average net profits of the immediately preceding three years on CSR activities.

Currently expenses on Corporate Social Responsibility Activities (CSR activities) as mandated by the Companies Act are not tax deductible

BRIEF HISTORY

The purpose of corporate social responsibility is to give back to the community, take part in philanthropic causes and provide positive social value. Businesses are increasingly turning to CSR to make a difference and build a positive brand around their company.

With the introduction of Section 135 in the Companies Act 2013, India became the first country to have statutorily mandated CSR for specified companies.

BRIEF HISTORY

The Income Tax Act specifically prohibits deduction of such amounts against taxable business profits. Thus, where the donor/ company spends on its own CSR activities or initiatives (and not contributed to other charitable organisations or societies), the donor stands in a disadvantageous position.

Notably, in countries where CSR is mandatory, deduction of expenses is allowed from the taxable income. Tax deductions of CSR expenses have long acted as an incentive for companies to invest in developmental projects. Philippines allows deduction of all expenses incurred by any corporation whether a large taxpayer or not, in the exercise of its CSR from the taxable income.

In Singapore, businesses that send employees to volunteer and provide services to approved charitable institutions within a specified period are allowed to deduct 250 per cent of the wages and incidental expenses incurred, subject to certain conditions. Malaysia offers tax incentives in the form of deduction of expenses incurred by taxpayers on provision of services, public amenities, education, health, housing, etc.

CSR expenses are all connected to social and charitable causes and not for any personal benefit or gain. It is, therefore, only fair to allow the same as business expenditure.

There is a school of though that such CSR expenditure may be available as a deduction on the grounds of such expenditure being 'commercially expedient'. We discuss below in an illustration.

ILLUSTRATION

Expenditure incurred by a company towards renovation of primary schools in its neighbourhood to muster the support of the local community there can qualify as an expense on that activity of the company which falls within its object clause (which is likely) and thus such an activity ultimately helps the company in fulfilling the main objects stated in its MoA. Therefore, even under current laws, such type of expenditure may be justified on the ground of 'commercial expediency' according to section 37 and can be claimed as deduction.

On the other hand, this expenditure on renovation of a school may not still be expenditure incurred in the business' 'normal' course of operations according to rule 4(1) and is thereby not disqualified from being CSR expenditure in terms of section 135. Therefore, it would be an incorrect proposition that due to rule 4(1), as a matter of universality, the CSR expenditure incurred in terms of section 135 would always be expenditure that cannot be justified on the ground of commercial expediency under section 37.

RELEVANT REGULATION

Income Tax Act, 1961

16 Category III AIFs post 2019 are not considered as a pass through and are taxed at investor's slab

POLICY RECOMMENDATION

- As in case of capital gain, Category I and II AIFs are considered as a pass through entity and the gains are taxed in the hands of investor, the same treatment should also be considered for gain arising to AIF for participating in Commodity Derivatives i.e. Cat III AIFs.

OR

- The maximum rate of tax should not be more than individual's maximum marginal rate.

BRIEF HISTORY

In 2019, their status was shifted for taxation purposes, to being treated as an assessee- which made the tax slabs very high.

RATIONALE

The taxation on Category III AIFs is 42.7 percent (For income > Rs 5 crore - 30 % + surcharge & cess = 42.7%). This decision needs a relook as the investor has no incentive to trade through a category III AIF.

Current existing tax rate applicable (42.7 per cent) is causing undue hardship and will not allow the markets to develop.

RELEVANT REGULATION

Income Tax Act, 1961

INDIRECT TAXES

6. PARITY

SNAPSHOT

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
17	Relax GST requirement for online MSMEs and simplify GST process	**Option 1:** ◆ Let any MSME irrespective of whether they sell offline or online be liable for GST only at a threshold value. **Option 2:** ◆ Allow the e-commerce operator to discharge the GST on behalf of MSMEs having turnover below the prescribed threshold, not having registered GST number and supplying goods through the e-commerce platform, under the ambit of section 9(5) of the CGST Act ◆ The e-commerce platform shall collect and pay GST at flat 5 per cent on all the eligible products of the small suppliers selling online u/s 9(5) of the CGST Act ◆ In case supplier is covered under section 9(5), then the online MSME need not require registration under CGST laws under section 24 (ix). Alternatively, if the supplier is still required to register under GSTN, they should be exempted from filing monthly GST returns **Others:** ◆ Mandatory Udyam Aadhar registration for all suppliers selling online ◆ Simplify the GST process including return filing in general and make the GST website, easy to navigate for all suppliers
18	Refund in case of inverted duty structure	◆ Amend Rule 89(3) to explicitly state that in case of inverted duty structures, refunds would be available on ITC for services as well ◆ While rationalization of GST structure and reduction in the number of rates should eliminate the incidence of inverted duty structures, in the interim, allowing ITC on services would go a long way in assisting taxpayers to reduce their costs and manage cashflows

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
19	Refund of ITC on capital goods utilised for provision of export services when export is under LUT or bond without payment of duty	◆ Allow utilisation of ITC on capital goods to claim refund when exporter of services opts to claim refund without paying GST ◆ The credit may be determined and allowed on an yearly basis based on the proportion of turnover of exports to total turnover - similar to the method currently followed for apportioning credit and determining the refund amount on input services and goods
20	Utilisation of ITC to pay GST under reverse charge	◆ Taxpayers to be given an option to utilise existing un-utilised ITC to discharge their GST liability under reverse charge mechanism (RCM). Since the impact of either paying GST upfront in cash (as ITC is available later) or utilising existing ITC is the same. This would help taxpayers in managing cash flows better.
21	Place of provision of services by domestic intermediary	◆ Amend the relevant sections to change the place of supply for domestic intermediary from location of intermediary to location of the service recipient (similar to exports), so that such intermediaries can be at par with exporters and are not required to pay GST on services rendered to overseas clients. ◆ Further, to bring domestic intermediaries at par with overseas intermediaries, in case the 'place of supply' is changed to the location of the service recipient for all intermediaries (irrespective of service providers being domestic or overseas), overseas intermediaries may be required to pay GST in India
22	Composition of Authority of Advance Ruling (AAR) for indirect taxes	◆ Make AAR under GST laws more diverse and include members who are not from the revenue department similar to the practise under income-tax laws

17 Relax GST requirement for online MSMEs and simplify GST process

POLICY RECOMMENDATION

Option 1:

- Let any MSME irrespective of whether they sell offline or online be liable for GST only at a threshold value.

Option 2:

- Allow the e-commerce operator to discharge the GST on behalf of MSMEs having turnover below the prescribed threshold, not having registered GST number and supplying goods through the e-commerce platform, under the ambit of section 9(5) of the CGST Act
- The e-commerce platform shall collect and pay GST at flat 5 per cent on all the eligible products of the small suppliers selling online u/s 9(5) of the CGST Act
- In case supplier is covered under section 9(5), then the online MSME need not require registration under CGST laws under section 24 (ix). Alternatively, if the supplier is still required to register under GSTN, they should be exempted from filing monthly GST returns

Others:

- Mandatory Udyam Aadhar registration for all suppliers selling online
- Simplify the GST process including return filing in general and make the GST website, easy to navigate for all suppliers

DESCRIPTION

MSMEs, with **63** million units, constitute about **90 per cent** of all enterprises in India, employing over **120 million people** and contribute significantly to the GDP. This excludes the millions of small units operating from homes such as housewives, small boutiques, mom and pop stores etc, which are estimated to be over **15 million.** It is estimated that MSME sector contributes around **30 per cent** of the GDP and to more than **40 per cent** of export. Further, around 85 per cent of all MSMEs are unregistered.

MSMEs form the bulk of Indian firms in the formal sector. While over **13 million** firms are registered under the GSTN, about 9 million firms are filing GSTR 3B currently.

While India is poised for a strong growth in e-commerce, currently less than 10 per cent out of India's 80+ million small businesses sell online (including mom and pop stores), while less than 15 per cent of Indian retail market is organised.

As per Section 24(ix) of CGST Act, 2017, any person who supplies goods through an e-commerce operator, is required to compulsorily register under GST, irrespective of the turnover of such persons. Accordingly, even where the turnover does not cross threshold limit, such MSMEs would be required to register under GST and undertake all subsequent compliances under GST.

If the same seller was to establish a bricks and mortar business, the MSME won't be required to take a GST registration until the turnover hits a minimum threshold. **This discrepancy in procedure puts Digital India at a disadvantage against physical world and disincentivizes setting up electronic businesses.**

Considering that the intention of the government to introduce threshold limit for registration was to reduce the burden on such MSMEs; bringing MSMEs undertaking supplies through e-commerce operators under the net of GST registration does not hold good with the intent of the government. These sellers mainly consist of individuals and small businesses (including homemakers) whose turnover is below the prescribed registration threshold and thus are not currently registered under the CGST Act. This also creates disparity as offline suppliers are exempt from GST registration upto a turnover of **Rs 40 lakh.**

PERIODIC COMPLIANCES

- MSMEs operating through e-commerce operators are burdened with periodical compliances like monthly returns, reconciliation of TCS amounts, etc.
- Further, considering that MSMEs may be undertaking compliances manually without any technology aid, it poses challenges in terms of undertaking reconciliations, keeping track of the TCS collected and remitted, credit reconciliations, etc. for such MSMEs.
- Someone who has only seen internet via a mobile, finds it difficult to deal with the process and the website complexity. Unfortunately, the GST process, website and filing returns regularly is quite cumbersome, which acts as a major deterrent for small and mid-sized sellers covered under SME sector from starting/ expanding their businesses through e-commerce platforms.
- Thus, these suppliers continue to sell offline and are unable to leverage the wide access/ market reach provided by e-commerce platforms. This also results in loss of indirect tax revenue for the government as growth is constrained.

RATIONALE

GST Registration for small online sellers is a huge bottleneck for online business. In the spirit of promoting Digital India and not placing it on a lower pedestal than the brick and mortar businesses, Option 1 is preferred.

Under Option 2, if the e-commerce operator is made liable for discharge of GST of the goods sold on its platform, there is no question of tax evasion. This would increase the indirect tax collection of the government as hitherto, goods excluded from GST taxation for small suppliers, would now be taxed at a prescribed rate by the e-commerce operator.

This is in line with the similar relief provided to specific categories of service providers making supplies through e-commerce platform, under section 9(5), wherein, all the provisions of the CGST Act shall apply to such e-commerce operator as if he is the supplier of such services (and liable for paying the tax in relation to the supply of such services while the supplier is not required to register under GSTN.

Currently the three services notified under section 9(5) of CGST are:

radio-taxis (e.g. Ola/ Uber platform);

hotels, inns, guest houses, clubs, campsites or other commercial places meant for residential or lodging purposes except where the person supplying such service through e-commerce operator (e.g. Oyo Rooms, MakeMyTrip) is liable for registration under section 22(1) of the CGST Act;

house-keeping such as plumbing, carpentering etc, except where the person supplying such service through e-commerce operator (e.g. Urban Clap) is liable for registration under section 22(1) of the GCST Act

Notably, the hesitation of small business to register under GSTN is not to evade tax but to avoid the cumbersome and time-consuming registration and returns filing process. It would therefore be prudent for the government to simplify the entire GST process and website in the interest of all suppliers online as well as offline. The lengthy and complex process becomes burdensome and instead of facilitating and empowering business, it becomes a deterrent and hindrance for the business to initiate, grow and thrive

Mandatory Udyam Aadhar, which is also known as Aadhar for Business, is a twelve-digit Unique Identification Number provided by the Ministry of MSME. It can be used to track business levels of online suppliers.

ILLUSTRATION

Meesho with a supplier base of 1 lakh suppliers, testifies that it has to reject more than 70 per cent of small suppliers due to the issue of GST registration. Else their supplier base would have been 3x had the GST registration issue not been there.

RELEVANT REGULATION

The Central Goods and Services Act, 2017

18 Refund in case of inverted duty structure

POLICY RECOMMENDATION

- Amend Rule 89(3) to explicitly state that in case of inverted duty structures, refunds would be available on ITC for services as well
- While rationalization of GST structure and reduction in the number of rates should eliminate the incidence of inverted duty structures, in the interim, allowing ITC on services would go a long way in assisting taxpayers to reduce their costs and manage cashflows

DESCRIPTION

An inverted duty structure is one where the GST rate applicable on output supplies is lower than the GST rate applicable on input goods and services. Due to such mismatch, there is significant accumulation of Input Tax Credit ("ITC") for the supplier

RATIONALE

While Section 54 of CGST Act read with Rule 89 of the CGST Rules do provide for a mechanism to determine the quantum of refunds available to taxpayer, the language used in Rule 89 states that Net ITC means input tax credit only on 'inputs', which gives the impression that the refunds would be restricted to ITC only on input goods and not services.

RATIONALE

This issue is currently under litigation and contrary views have been expressed by different high courts. The Gujrat High Court in the case of VKC footsteps [2020 (7) TR 3153] had upheld the right of the taxpayer to claim input tax credit on services in an inverted duty structure scenario, whereas the Madras High Court in the case of Tvl Transtonnelstroy Afcons Joint Venture v Union of India [2020 (9) TMI 931] ruled in the negative

RELEVANT REGULATION

The Central Goods and Services Act, 2017

19 Refund of ITC on capital goods utilised for provision of export services when export is under LUT or bond without payment of duty

POLICY RECOMMENDATION

- Allow utilisation of ITC on capital goods to claim refund when exporter of services opts to claim refund without paying GST
- The credit may be determined and allowed on an yearly basis based on the proportion of turnover of exports to total turnover - similar to the method currently followed for apportioning credit and determining the refund amount on input services and goods

DESCRIPTION

As per the current provisions exporters of goods/ services have two options to claim refund of input tax credits:

Option 1:
Export of goods and services under a LUT or bond without paying GST and claim a refund ITC that has not been utilised

Option 2:
Export of goods or services along with payment of GST and claiming a refund of such GST

While the law allows the taxpayer to claim a refund of un-utilised ITC on capital goods under Option 2, such refund/ utilisation of ITC on capital goods is not allowed under Option 1.

RATIONALE

An exporter of services (say IT services) would normally have expenses such as salary costs, professional services and investment in capital goods like laptops, servers, furnishing and fixtures etc. These capital goods are integral to provision of services and hence ITC on such goods should be considered while allowing refund to such exporters of services

RELEVANT REGULATION

The Central Goods and Services Act, 2017

20 Utilisation of ITC to pay GST under reverse charge

POLICY RECOMMENDATION

- Taxpayers to be given an option to utilise existing un-utilised ITC to discharge their GST liability under reverse charge mechanism (RCM). Since the impact of either paying GST upfront in cash (as ITC is available later) or utilising existing ITC is the same. This would help taxpayers in managing cash flows better.

DESCRIPTION

As per Section 9(3) of CGST Act, under Reverse Charge Mechanism ('RCM') recipient of goods and/ or services is required to pay GST (instead of the supplier of goods or services) in a number of cases, which have been notified.

The recipient paying GST under RCM is not allowed to utilise existing ITC to discharge such liability and has to necessarily pay the tax liability in cash. Credit for such taxes paid are allowed subsequently. In situations where the output liability of the service recipient is less than accumulated ITC, GST paid under reverse charge mechanism may become a cost.

RATIONALE/ ILLUSTRATION

An Indian professional services firm seeks advice from an overseas service provider on IT related services or other professional services (legal services, accounting services etc.).

The Indian firm would be required to pay GST to the Indian exchequer on payments made for services provided by the overseas firm and such GST would be available as ITC to the Indian firm.

In cases where the output liability of the Indian firm is minimal, this ITC essentially becomes a cost and would be unutilized. If the Indian firm had been allowed to utilize existing ITC, there would be no cash payment or accumulation of ITC

RELEVANT REGULATION

The Central Goods and Services Act, 2017

21 Place of provision of services by domestic intermediary

POLICY RECOMMENDATION

- Amend the relevant sections to change the place of supply for domestic intermediary from location of intermediary to location of the service recipient (similar to exports), so that such intermediaries can be at par with exporters and are not required to pay GST on services rendered to overseas clients.
- Further, to bring domestic intermediaries at par with overseas intermediaries, in case the 'place of supply' is changed to the location of the service recipient for all intermediaries (irrespective of service providers being domestic or overseas), overseas intermediaries may be required to pay GST in India.

DESCRIPTION

Section 2(13) of IGST Act defines an intermediary as a broker, an agent or any other person, by whatever name called, who arranges or facilitates the supply of goods or services or both, or securities, between two or more persons, but does not include a person who supplies such goods or services or both or securities on his own account

As per section 13(8), the place of supply of services for an intermediary is the location of the intermediary.

RATIONALE

In light of the above, a number of Indian residents who are acting as intermediaries for overseas clients (such as those providing marketing support services or commission agents), end up paying GST even though there is a strong case that their services are in the nature of 'exports' (which are not subject to GST).

The current definition also leads to situations where domestic intermediaries are at a significant disadvantage when compared with their overseas counterparts.

ILLUSTRATION

I Co is an Indian travel aggregator and helps Indian customers book flights, hotels and other travel related services. I Co charges a fee from both customers and businesses which are listed on it (hotels, airlines, etc.).

F Co is a foreign travel aggregator that provides similar services to customers across the world including Indian customers.

In light of the definition of an intermediary as it stands today, I Co would be required to collect GST on any fee it collects, whereas F Co (due to being located outside India) would not be required to charge GST on any fee it collects from Indian customers/ businesses

RELEVANT REGULATION

The Central Goods and Services Act, 2017

22 Composition of Authority of Advance Ruling (AAR) for indirect taxes

POLICY RECOMMENDATION

- Make AAR under GST laws more diverse and include members who are not from the revenue department similar to the practise under income-tax laws

RATIONALE

AAR was set-up to provide clarity on tax issued in a speedy manner and avoid the normal litigation cycle (which takes a number of years for final resolution).

While each state has an authority for providing such advance rulings, each authority is composed of two members not below the rank of Joint commissioner - one from the centre and one from the state.

In contrast, under Income tax laws, the composition of the AAR consists of members with different qualifications such as retired Supreme court/ high court judges and members of the Indian Revenue Services (IRS), direct/ indirect tax bodies etc.

It has been observed that taxpayers are hesitant to approach the AAR for GST related issues since the authority consists only of members from the revenue department and also in light of a slew of judgements that are against the taxpayers and in favor of the revenue.

RELEVANT REGULATION

The Central Goods and Services Act, 2017

7. CASHFLOW

SNAPSHOT

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
23	Availing ITC on advance payments for goods and services	◆ Make suitable amendments to ensure that either A) ITC on advance payments for goods and services is available on payment or B) In case of advance payments, the supplier is not required to pay GST till completion of services
24	Payment of GST on cash basis for small businesses and professionals	◆ Payment of GST on cash basis (i.e. on receipt of cash from customers) for small businesses below a certain threshold of say Rs 2 crore

23 Availing ITC on advance payments for goods and services

POLICY RECOMMENDATION

- Make suitable amendments to ensure that either

  A) ITC on advance payments for goods and services is available on payment or

  B) In case of advance payments, the supplier is not required to pay GST till completion of services

DESCRIPTION

As per section 12 and 13 of the CGST Act, the liability to pay GST arises at the earliest of the following:

(a) Date of issue of invoice

(b) Date of provision of services (when invoice is not issued within prescribed time)

(c) Receipt of payment

However, per Section 16 of the CGST Act, ITC can be claimed only when goods or services have actually been received by the recipient.

RATIONALE

Due to this, there might be a timing difference in payment of GST and claim of credit, leading to working capital/ cash flow issues for recipients especially in businesses with low margins. Furthermore, under erstwhile service tax regime utilization of input service tax credit on advance payments was allowed

ILLUSTRATION

For e.g. The gold bullion industry works on an advance payment model and a number of such traders may be facing issues related to claiming ITC when delivery of goods is significantly delayed.

RELEVANT REGULATION

The Central Goods and Services Act, 2017

24 Payment of GST on cash basis for small businesses and professionals

POLICY RECOMMENDATION

- Payment of GST on cash basis (i.e. on receipt of cash from customers) for small businesses below a certain threshold of say Rs 2 crore

DESCRIPTION

As discussed above, the liability to pay GST arises on the earlier of:

(a) Date of issue of invoice

(b) Date of provision of services (when invoice is not issued within prescribed time)

(c) Receipt of payment

RATIONALE

There are a number of cases (especially professional firms and small businesses) where there is a large delay between provision of services/ raising invoice and actual payment by the customers, leading to a cash flow/ working capital management issues.

It is also noteworthy that the IT Act provides an option to taxpayers to pay income tax on business profits and income from other sources on cash basis (and not accrual basis).

ILLUSTRATION

I Co is an Indian company which provides professional services. In such industries, it is very common that the credit period is very long (sometimes as long as a year). When I Co provides services in say Year 1, it has to immediately discharge GST and most likely out of its own funds, whereas payments for these services may be received only in Year 2 - leading to a working capital issue for I Co.

RELEVANT REGULATION

The Central Goods and Services Act, 2017

8. Ease of Doing Business (EoDB)

SNAPSHOT

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
25	Rationalisation of GST rate structure	◆ Simplify and reduce the number of rates in GST from the current 5 rates to say 3 rates say 5 per cent, 15 per cent and 28 per cent
26	Language of GST portals and website	◆ Make GST websites and portals user-friendly by making them available in local languages, in addition to English

25 Rationalisation of GST rate structure

POLICY RECOMMENDATION

- Simplify and reduce the number of rates in GST from the current 5 rates to say 3 rates say 5 per cent, 15 per cent and 28 per cent

RATIONALE

When GST was conceptualized and implemented, the emphasis was on making the indirect tax set-up, simple and seamless in India. The existence of 5 different rates goes against this principle and has only complicated matters.

Lesser the no of rates, lesser the complications. Reducing the number of GST rates (from 5 to say 3) would greatly help in simplifying the tax structure, reduce confusion and litigation around classification of goods under different rates and ensure that the occurrence of inverted duty structures is minimized.

Furthermore, most developed and developing countries have a single rate GST/ indirect tax structure, which simplifies the entire GST/ VAT regime. For e.g. Australia has a single GST rate of 10 per cent and Singapore has a single GST rate of 7 per cent.

As per reports, the GST revenue neutral rate is 15.5 per cent, while the actual average GST rate is ~12 per cent. Thus, the recommendation of 3 rates of 5 per cent, 15 per cent and 28 per cent.

RELEVANT REGULATION

The Central Goods and Services Act, 2017

26 Language of GST portals and website

POLICY RECOMMENDATION

Make GST websites and portals user-friendly by making them available in local languages, in addition to English

RATIONALE

As discussed earlier, GST was implemented with the view to simplify the indirect tax landscape in India, make it more accessible and widen the tax base.

A number of small taxpayers have indicated that the GST portal and websites are available only in English language and making it available in other local languages will make it easier for such taxpayers to meet their reporting and compliance obligations.

It is noteworthy that websites related to state taxes (say property tax, stamp duty tax etc) are available in English as well as the pre-dominant language of that particular state.

RELEVANT REGULATION

The Central Goods and Services Act, 2017

9. MISCELLANEOUS

SNAPSHOT

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
27	Bring petroleum, diesel and other associated products within the fold of GST	◆ Bring petrol, diesel and other such products within the ambit of GST
28	ITC on CSR expenses	◆ Allow corporates to claim ITC of goods and services which are used as part of meeting CSR obligations under Companies Act

27 Bring petroleum, diesel and other associated products within the fold of GST

POLICY RECOMMENDATION

- Bring petrol, diesel and other such products within the ambit of GST

DESCRIPTION

India levies one of the highest taxes on petrol and diesel in the world. Centre and states together earn over Rs 5 trillion annually from tax on petroleum products.

At present, **60 per cent tax** is being collected on petroleum products. If they are brought under GST, it would result in a shortfall of Rs 2 to 2.5 trillion cumulatively to both the centre and states.

Finance minister Nirmala Sitharaman had recently said in Lok Sabha that she would be "glad" to discuss the suggestion of bringing petrol and diesel under the ambit of the GST. The duties on petrol are levied both by the Centre and the states and both would have to work together on this. There were no hurdles from the Centre's side, and the GST Council would have to take a call.

BRIEF HISTORY

After widespread consultation with stakeholders, the NDA government introduced the 122nd Constitution Amendment Bill in 2014, whereby the only exclusion from GST was alcoholic liquor for human consumption and a provision to the effect that the aforesaid petroleum products would be subjected to GST with effect from such date as the council may recommend.

Such a delayed choice approach was adopted in view of the reluctance of states to subject around 25-30 per cent of their assured tax revenues to the initial uncertainties of a new tax regime.

Accordingly, sections 9(2) and 5(2) of the CGST/SGST Act and the IGST Act respectively, explicitly provide for levy of GST on these products with effect from such date as the Council may recommend. This was a far-sighted move on the part of the NDA government which now enables the levy of GST on these products without making any further amendment to the Constitution.

RATIONALE

Unification of the tax on petrol and diesel is required across states. Currently, petrol, diesel and other associated products are not subject to GST, but are subject to excise tax (by the union government) and VAT (levied by each state at different rates). For example, Rajasthan levies the highest local taxes (value added tax or VAT) on petrol and diesel, followed by Madhya Pradesh, Maharashtra, Andhra Pradesh and Telangana. So, for these states the cumulative (Centre and states) tax component is more than 60 per cent.

Due to this, a number of businesses are unable to avail input credit of excise/ VAT paid on such products and hence such taxes become cost to the business.

High oil prices add to inflationary pressures. Petrol and diesel have a combined weight of 4.69 per cent in the wholesale price index (WPI) and 2.34 per cent in the retail price index (RPI). Any increase in the prices of the transport fuels affects the WPI more than the consumer price index (CPI) but what is more worrisome is the pass-through effect the increase in fuel prices can cause.

Record high prices for diesel means that the cost of transporting goods goes up across the country which in turn could result in increasing the prices of essential commodities like fruit and vegetables as well. Household incomes see a perceptible drop and gradually even the demand for discretionary goods starts declining.

India's RPI has hit **6.3 per cent** in May 2021, according to the latest available numbers. This is half a percentage point higher than RBI's threshold of 6 per cent. It is the RPI data that is mainly factored in by the RBI while setting the benchmark interest rates. The RBI will not be able to cut the key interest rates till inflation remains high and this prevent industrial and personal loans from becoming cheaper, which is the need of the hour at a time when the pandemic has hit India's demand and consumption like never before.

RBI Governor Shaktikanta Das too has urged the government for a calibrated unwinding of fuel taxes to reduce price pressure in the economy. Levying GST on petrol products at 28 per cent would go a long way to ease such pressures.

Prices of petrol and diesel in the neighbouring countries of China, Pakistan, Bangladesh, Sri Lanka, Nepal, Bhutan and Myanmar are much lower than that of India, according to globalpetrolprices.com that tracks retail prices of motor fuel, electricity, and natural gas in over 150 countries. None of these produce their own oil. They too import a substantial proportion but taxes in these countries are not as high.

In Canada, the tax on these products ranges from 15 per cent GST (5 per cent in case of non-participating provinces) plus around 25 to 30 cent per litre. USA imposes taxes at rates as low as around 15 per cent. In the EU, the taxes ranges from around 45 per cent to 60 per cent.

For economic recovery to happen post pandemic, economists believe it is important that taxes on petroleum and its products are reduced. It happened during the global financial crisis of 2008-09 and gave an immediate push to the factory production and the economy.

Inflationary risks are higher in 2022-23, as global oil price forecast, has now revised up to $75 a barrel, from $60 previously for 2022, as per Wall Street brokerage Bank of America Securities report.

ILLUSTRATION

The excise duty from petroleum products contributes up to 90 per cent of all excise duty collected by the Centre. . The Centre levies an excise duty of Rs 33 on a litre of petrol. The states charge VAT of Rs 23 or thereabouts. It varies from state to state because some of them charge high VAT. Before May 2014, excise duty on petrol was Rs 9.48 per litre - the current rate of Rs.33 is almost a 230 per cent increase in seven years. On diesel, central taxes were Rs 3.56 a litre, prior to 2014. Today it is about Rs 32.

On July 1 2021, petrol was delivered to petrol pumps at Rs 39.30 per litre. This was the price charged to dealers but consumers have ended up paying over Rs 100 per litre for petrol for a long time. Rajasthan was the first state to witness petrol hitting Rs 100 a litre mark in mid-February 2021 itself. Similar is the case with diesel. While at pumps, diesel is delivered at Rs 41.74 a litre, it is sold for more than Rs 100 per litre in many states.

RELEVANT REGULATION

The Central Goods and Services Act, 2017

28 ITC on CSR expenses

POLICY RECOMMENDATION

- Allow corporates to claim ITC of goods and services which are used as part of meeting CSR obligations under Companies Act
- The amount of deduction can be capped to the minimum amount prescribed by the Companies Act

DESCRIPTION

As per section 135 of the Companies Act, certain companies (whose turnover, net worth, net profit etc. exceeds a prescribed threshold) are required to spend at least 2 per cent of their average profits earned during the past three fiscal years on CSR activities

RATIONALE

The law is unclear as to whether ITC on goods/ services purchased for complying with the aforesaid CSR obligation would be available to the taxpayer

The issue is further complicated by the fact that Section 17(5)(f) states that ITC would not be available on disposed off goods by way of 'gift' or 'free sample'.

CSR expenses incurred by corporates are mandated by law and denying ITC on such expenses is a double whammy to taxpayers.

ILLUSTRATION

An IT company procures laptops to distribute them to the poor and underprivileged. When the IT company procures such laptops, it would have paid GST, however owing to the ambiguity in law, such credit would not be available.

RELEVANT REGULATION

The Central Goods and Services Act, 2017

RECAP

DIRECT TAXES

1. PARITY

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
1	Section 9 - Applicability of indirect transfer provisions to multi layered overseas funds	The benefit accorded to non-residents who have invested indirectly in specific funds can also be extended to other overseas funds that invest directly into India. Some illustrative conditions to extend this benefit could be: ◆ Investors in the fund may not be subject to Indian capital gains tax when the overseas fund is subject to capital gains tax in India (i.e. one level tax) ◆ Entities which are registered under fund regimes of overseas jurisdiction or are registered under a new and separate Indian regime (which could be handled by SEBI or CBDT) could be provided with this benefit (similar to registrations for Category I and II FPIs). ◆ In either of the above scenarios, additional safeguards such as minimum number of investors, investors not being related parties or part of the same group, minimum corpus etc. may be specified to ensure that the benefit is granted to genuine funds.
2	Section 72A - Transition of losses on mergers and corporate reorganisations	◆ Provide greater flexibility to businesses which are not engaged in any of the prescribed activities to transition (carried forward/ set-off) losses as part of an amalgamation/ merger at par with demerger (Prescribed activities such as the manufacture or processing of goods/ computer software, generation or distribution of electricity or any other form of power, providing telecommunication services, mining, construction of ships, aircrafts or rail systems)
3	Rationalisation of capital gains tax rate on sale of shares by residents	◆ In order to give incentive to domestic investors, the long term capital gains tax rate for residents on sale of unlisted shares can be reduced to 10 per cent (to maintain parity with the rate applicable to non-resident corporates)

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
4	Rationalisation of income-tax rate for LLPs and partnership firm	◆ Extend the benefit of lower income tax rates to firms and LLPs as well. ◆ A threshold limit, say turnover of below Rs 10 crore, could be considered
5	Allow registered valuers to issue valuation reports under premium tax provisions	◆ Taxpayers to be given the option to obtain valuation reports from valuers registered under the companies act (i.e. registered valuers'), considering the cost involved in obtaining valuation reports from merchant bankers

2. CASHFLOW

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
6	Section 50CA; Capital gains payable on difference between transaction/ transfer value and prescribed fair value of unquoted shares	◆ The taxpayer must be given an option to consider either the book value or the actual fair value (backed by a valuation report issued by merchant banker/ accountant) for computing capital gains for the purpose of section 50CA.
7	Section 56(2)(x) - Gift tax	◆ Give taxpayer an option to consider 'book value' or actual fair value for equity shares. ◆ For listed shares, fair value/ quoted price to be considered as the trading price of the shares on the date when definitive agreements to acquire shares were first entered into (and not actual date of transfer).
8	Section 56(2)(viib) Premium Tax	◆ To provide a specific carve-out for restructuring transactions such as court approved mergers, demergers, business transfers and other reconstructions.
9	Swap of Shares	◆ Exempt share swap transactions and require sellers to pay tax only when cash is realised on subsequent sale. The period of holding and the cost of such exchanged shares can relate back to the original shares ensuring no loss to the revenue ◆ Since the transaction would be 'exempt', the sellers should compulsorily report such share swap transactions in the return of income for the relevant financial year

3. REVISION WITH TIME

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
10	Section 54EC - Capital gains relief on investment in government bonds	◆ In order to mobilise funds, the government could look at increasing the limit of Rs 50 lakh to say Rs 1 crore or more. ◆ A lock- in for a longer duration than the current duration of 5 years may be considered
11	Section 71(3A) - Limit on deduction of interest on home loans for self-occupied property	**Option 1:** ◆ Limit of Rs 2 lakh to be removed altogether **Option 2:** ◆ Separate limits can be introduced for metro and non-metro cities - considering that the cost of real estate and housing is higher in such cities. A similar concession has been made for determining the quantum of house rent allowance in Rule 2A of the Income-tax Rules, 1962 **Option 3:** ◆ The amount of interest deduction may be capped with reference to the interest amount - say 50-75 per cent of interest paid in a year maybe allowable as a deduction The exact mechanism/ option should be selected after analysing the current trends in the real estate sector and undertaking a cost-benefit analysis vis-a-vis loss of tax revenue and overall economic impact of the concession.

4. Ease of Doing Business (EoDB)

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
12	Section 194O; TDS of 1 per cent by E-Commerce Sites	◆ Either TDS u/s of Income Tax Act or TCS u/s 52 of CGST Act should be levied, not both. ◆ There should be greater co-ordination between Income Tax and GST departments to track the tax payer. **Option 1:** ◆ Scrap section 194O **Option 2:** ◆ Extend the benefit of 'no TDS on GST component' to sale of goods as well to achieve parity with services through e-commerce sites ◆ Explicitly clarify that TDS is applicable only on the sale price component and not on other amounts charged by e-commerce operator (e.g. transportation charges) to the end customers
13	Date of balance sheet for the purpose of section 56(2)(x)	**Option 1** ◆ Allow use of last adopted or last audited balance sheet to determine fair value of unlisted equity shares **Option 2** ◆ Provide flexibility by allowing taxpayers to use un-audited or management accounts.
14	Remove matching system for TDS credit	◆ Allow credit of TDS in the year of deduction itself and not require matching of TDS with the year of accrual of income.

5. MISCELLANEOUS

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
15	Section 37 –CSR activities is not tax deductible	◆ Allow deduction for expenses on CSR activities undertaken by corporates. ◆ The amount of deduction can be capped to the minimum amount prescribed by the Companies Act
16	Category III AIFs post 2019 are not considered as a pass through and are taxed at investor's slab.	◆ As in case of capital gain, AIF is considered as only the pass through entity and the gains are taxed in the hands of investor, the same treatment should also be considered for gain arising to AIF for participating in Commodity Derivatives. OR ◆ The maximum rate of tax should not be more than individual's maximum marginal rate.

INDIRECT TAXES

6. PARITY

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
17	Relax GST requirement for online MSMEs and simplify GST process	**Option 1:** ◆ Let any MSME irrespective of whether they sell offline or online be liable for GST only at a threshold value. **Option 2:** ◆ Allow the e-commerce operator to discharge the GST on behalf of MSMEs having turnover below the prescribed threshold, not having registered GST number and supplying goods through the e-commerce platform, under the ambit of section 9(5) of the CGST Act ◆ The e-commerce platform shall collect and pay GST at flat 5 per cent on all the eligible products of the small suppliers selling online u/s 9(5) of the CGST Act ◆ In case supplier is covered under section 9(5), then the online MSME need not require registration under CGST laws under section 24 (ix). Alternatively, if the supplier is still required to register under GSTN, they should be exempted from filing monthly GST returns **Others:** ◆ Mandatory Udyam Aadhar registration for all suppliers selling online ◆ Simplify the GST process including return filing in general and make the GST website, easy to navigate for all suppliers
18	Refund in case of inverted duty structure	◆ Amend Rule 89(3) to explicitly state that in case of inverted duty structures, refunds would be available on ITC for services as well ◆ While rationalization of GST structure and reduction in the number of rates should eliminate the incidence of inverted duty structures, in the interim, allowing ITC on services would go a long way in assisting taxpayers to reduce their costs and manage cashflows

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
19	Refund of ITC on capital goods utilised for provision of export services when export is under LUT or bond without payment of duty	◆ Allow utilisation of ITC on capital goods to claim refund when exporter of services opts to claim refund without paying GST ◆ The credit may be determined and allowed on an yearly basis based on the proportion of turnover of exports to total turnover - similar to the method currently followed for apportioning credit and determining the refund amount on input services and goods
20	Utilisation of ITC to pay GST under reverse charge	◆ Taxpayers to be given an option to utilise existing un-utilised ITC to discharge their GST liability under reverse charge mechanism (RCM). Since the impact of either paying GST upfront in cash (as ITC is available later) or utilising existing ITC is the same. This would help taxpayers in managing cash flows better.
21	Place of provision of services by domestic intermediary	◆ Amend the relevant sections to change the place of supply for domestic intermediary from location of intermediary to location of the service recipient (similar to exports), so that such intermediaries can be at par with exporters and are not required to pay GST on services rendered to overseas clients. ◆ Further, to bring domestic intermediaries at par with overseas intermediaries, in case the 'place of supply' is changed to the location of the service recipient for all intermediaries (irrespective of service providers being domestic or overseas), overseas intermediaries may be required to pay GST in India
22	Composition of Authority of Advance Ruling (AAR) for indirect taxes	◆ Make AAR under GST laws more diverse and include members who are not from the revenue department similar to the practise under income-tax laws

7. CASHFLOW

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
23	Availing ITC on advance payments for goods and services	◆ Make suitable amendments to ensure that either **(A)** ITC on advance payments for goods and services is available on payment or **(B)** In case of advance payments, the supplier is not required to pay GST till completion of services
24	Payment of GST on cash basis for small businesses and professionals	◆ Payment of GST on cash basis (i.e. on receipt of cash from customers) for small businesses below a certain threshold of say Rs 2 crore

8. Ease of Doing Business (EoDB)

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
25	Rationalisation of GST rate structure	◆ Simplify and reduce the number of rates in GST from the current 5 rates to say 3 rates say 5 per cent, 15 per cent and 28 per cent
26	Language of GST portals and website	◆ Make GST websites and portals user-friendly by making them available in local languages, in addition to English

9. MISCELLANEOUS

SN	BRIEF DESCRIPTION	POLICY RECOMMENDATION
27	Bring petroleum, diesel and other associated products within the fold of GST	◆ Bring petrol, diesel and other such products within the ambit of GST
28	ITC on CSR expenses	◆ Allow corporates to claim ITC of goods and services which are used as part of meeting CSR obligations under Companies Act