PROPOSED AMENDMENTS TO INCOME TAX ACT, 1961 THROUGH FINANCE BILL, 2023 - BUSINESS INCOME :

CA. Nilesh Dedhia
Email : nilesh@shahnsavla.com

The finance minister presented the Budget 2023 in the parliament, while the economy was getting back and trying to recover from the havoc caused globally by the pandemic. The Budget was well received across, for aiming to attempt GDP growth, fiscal prudence and boosting consumption, a tight rope walk indeed.

There are few amendments which are clarificatory in nature, few aimed to rationalize certain provisions, while few others are a part of the socio economic welfare measures.

In this article, I have tried to analyse the proposed amendments in provisions relevant in calculating business income.

These are proposed to take effect from F.Y. 2023-24 (i.e. A.Y. 2024-25) unless otherwise specifically stated, subject of course, to passing of the Finance Bill by both the houses of the Parliament and assent by the President.

Section 28 Providing clarity on benefits and perquisites in cash

Section 28 of the Act provides for income that shall be chargeable to income-tax under the head 'Profits and gains of business or profession'. Clause (iv) thereof brings to tax the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession.

- The need for an amendment proposed in Section 28 cannot be adequately understood without making reference to Section 194R newly introduced by the Finance Bill 2022.

- To keep it crisp, Section 194R mandates TDS on the value of benefits or perquisites, whether convertible into money or not, arising from business or the exercise of a profession. The wordings are imported from clause (iv) of section 28. The explanatory memorandum to Finance Bill 2022 also clarified the intention of the legislature, to trace the value of such benefits or perquisites, like free tour packages, distribution of free samples, etc, which hitherto escaped the tax net on account of non-reporting of the same in the absence of TDS mandate on said payments / expenses.

- Clause (iv) was introduced in Section 28 through the Finance Act 1964 and the Circular no 20D dated 7th July 1964 issued to explain the provisions of this Act stated clearly that the benefit could be in cash or in kind. Therefore, the intention of the legislation while introducing this provision was also to include benefit or perquisite whether in cash or in kind. However, there have been host of decisions, including the landmark supreme court decision in CIT Vs. Mahindra and Mahindra (2018) 93 Taxmann.com 32(SC), in the context of clause (iv) of Section 28, holding that, considering the language used therein, the benefits which are purported to be charged under Section 28(iv) could only be those in kind.

- ❖ The Circulars issued to clarify provisions of Section 194R required TDS even in case of monetary benefits or perquisites. The said Circulars have stirred controversy in view of the decisions referred to above.

- ❖ Finally, to set at rest the controversy, legislature thought it prudent to simply amend clause (iv) of Section 28. It is therefore proposed that the benefits or perquisites shall be chargeable to tax as business income, whether convertible into money or not, or in cash or kind or partly in cash and partly in kind, arising from business or the exercise of a profession.

- ❖ This seemingly simple amendment would rather have far-reaching consequences which, probably, were neither envisaged nor expected, so to say, transactions pertaining to waiver of loan, albeit on capital account, may be unintendedly covered under the ambit of Section 28(iv). Even availing interest free loans could possibly attract Section 28(iv). It would be an ironical situation for an assessee to be made to pay tax on the value of benefit derived by waiver of loan. Further, in all extremities, can it be said that, owing to this amendment, all the business transactions could be tested from an Arm's Length Price perspective?

- ❖ What the courts have to say on the new law and the consequences it will have, only time will tell.

Section 35D : Ease in claiming deduction on amortization of preliminary expenditure

Section 35D of the Act allows deduction in respect of certain specified preliminary expenses like preparation of feasibility report, preparation of project report, legal charges, etc, incurred either during the pre-commencement stage of business or after commencement in connection with the extension of business undertaking or setting up a new unit.

- ❖ The deduction in respect of certain expenses is allowed if the work in connection with the specified activities is carried out either by the assessee himself or by a concern which is approved by the Board.

- ❖ There are numerous guidelines laid down by the Board for granting approval under section 35D(2)(a) like consideration of competence and expertise to render consultancy services, experience of at least one year in the field of consultancy services, etc. The form of application for approval is also exhaustive.

- ❖ In order to simplify the process of claiming deduction, the condition of approval by the Board is done away with. Instead, a procedural liability is proposed to be cast upon the assessee to furnish a statement containing the particulars of expenditure sought to be claimed, within the prescribed period and in the prescribed form and manner.

Section 43B and Section 43D : Non-Banking Financial Company (NBFC) categorization

- ❖ Section 43B (da) of the Act provides, that any sum payable by an assessee as interest on any loan or borrowing from a Deposit taking Non-Banking Financial Company and Systemically Important Non-Deposit taking Non-Banking Financial Company shall be allowed as deduction on payment basis. The same can be allowed on accrual basis if it is actually paid on or before the due date of furnishing the return of income of the relevant previous year.

- ❖ Section 43D of the Act provides for taxability of interest income in relation to certain categories of bad or doubtful debts earned, inter alia, by deposit-taking Non-Banking Financial Companies and Systemically Important Non-Deposit taking Non-Banking Financial Company. It provides that the said interests shall be chargeable to tax in the previous year in which it is credited to its profit and loss account for that year or actually received, whichever is earlier.

- Section 43B and section 43D of the Act currently use two erstwhile categories of NBFCs namely, Deposit taking Non-Banking Financial Company and Systemically Important Non-Deposit taking Non-Banking Financial Company. Such classification for non-banking financial companies is no longer followed by the Reserve Bank of India for the purposes of asset classification.

- In view of the above, it is proposed to amend Section 43B and Section 43D of the Act, to include 'such class of non-banking financial companies as may be notified by the Central Government in the Official Gazette, so as to align the classification of NBFCs with that done by the RBI.

Section 43B : Promoting timely payments to Micro and Small Enterprises

Section 43B of the Act provides for deduction in respect of certain expenses, which are otherwise allowable, to be allowed only on actual payment.

- In order to promote timely payments to micro and small enterprises, it is proposed to include payments made to such enterprises within the ambit of section 43B of the Act. At the cost of repetition, it may be noted that, payments made to micro and small enterprises only are covered. Payments made to medium enterprises are not covered within the ambit of Section 43B.

- The extended time limit for making such payments is not the due date for filing of return of income (ROI), unlike other payments covered under Section 43B, but the due date stipulated under Section 15 of the Micro, Small and Medium Enterprises Development (MSMED) Act 2006 (MSME Act).

- It may be worth mentioning here that, provisions of Section 23 of MSME Act, override the provisions of Income tax Act and provide that, interest paid to MSME is disallowed, regardless of the time of payment. Now, with the proposed amendment, other payments of any sum shall be liable for disallowance if not paid within the prescribed due date.

- Section 43B does not provide for any allowance, but disallows certain expenses, payments for which are made beyond the due date for filing ROI. Therefore, on an analysis of the provisions of Section 43B, one may argue that, payments to MSME made beyond the due date of MSME Act, but within the same financial year in which the expenses are incurred, can still be claimed in the same year and shall not be affected by the amended provision. To put it differently, it seems that the rigours of the proposed amendment shall only apply to payments outstanding as on 31^{st} March, if the same are paid beyond the time limit as per MSME Act.

- Further, expenses which are disallowed in the year during which they are incurred, due to non-payment within the time allowed, can be claimed in the subsequent year when the same are actually paid.

- With this amendment, even defaults in payments made by micro enterprises to small enterprises shall be covered, which would not go with the government's intent behind introduction of this provision.

- An even more serious issue is that, the provisions of Section are proposed to apply to micro and small enterprises as defined in the MSME Act. An apparent meaning is that the applicability is irrespective of whether the enterprises are registered as such under the MSME Act. This could lead to undesirable situations in the backdrop of the fact that, there are very few MSMEs registered as such under the MSME Act. Further, it would lead to practical issues in identifying whether the payee entity fits in the definition micro or small enterprise as defined in the MSME Act. Clarifications on these aspects shall have to be awaited.

Section 44AD : Increasing threshold limits for presumptive taxation schemes

Section 44AD of the Act, contains a scheme of presumptive taxation for small businesses. This scheme applies to resident individual, HUF or a partnership firm other than LLP. One of the conditions to be eligible to opt the scheme is the turnover of the assessee does not exceed rupees two crores.

Likewise, Section 44ADA of the Act contains a similar scheme for professionals having gross receipts not exceeding rupees fifty lakhs.

- ❖ Sub section (1) of Section 44ADA of the Act provides for a presumptive income scheme for small professionals. This scheme applies to certain resident assessee (i.e., an individual, partnership firm other than LLP) who are engaged in any profession referred to in subsection (1) of section 44AA, and whose total gross receipts do not exceed fifty lakh rupees in a previous year. As per the provision, a sum equal to 50% of the gross receipts can be consider as the profits and gains from profession. If assessee has claimed to have earned higher sum than 50%, then that higher sum is taxable.
- ❖ Under section 44AB of the Act, every person carrying on business is required to get his accounts audited, if his total sales, turnover or gross receipts, in business exceeds one crore rupees in any previous year. The limit is raised to ten crore rupees w.e.f FY 2020-21, where at least 95% of receipts/payments are in non-cash mode. In case of a person carrying on profession he is required to get his accounts audited, if his gross receipts in profession exceeds, fifty lakh rupees in any previous year. Those opting for and fulfilling the conditions laid in the presumptive scheme are exempt from audit under this section.
- ❖ In order to enable higher number of assessee to claim the benefit of this simplified scheme of computing business income, it is proposed to increase the existing threshold limits as under:
  - o Turnover of Rs. 3 crores for business
  - o Gross receipts of Rs. 75 lakhs for profession
  - o It is additionally proposed to be provided that the benefit of enhanced limits shall be available only if receipts in cash are less than 5% of Turnover or gross receipts.
- ❖ It is to be noted here that, since the ceiling on the quantum of cash transactions is proposed to be imposed only for the enhanced turnover limit, assessees having turnover less than the existing limits of Rs. 2 crores (business) or gross receipts less than Rs. 75 lakhs (profession) can still claim the benefit of presumptive taxation scheme irrespective of the quantum of cash transactions.
- ❖ It is also clarified that, receipt by a cheque drawn on a bank or by a bank draft, which is not account payee, shall be deemed to be receipts in cash.
- ❖ Consequent amendment is also proposed to Section 44AB by inserting proviso, that assessee would not be liable for tax audit u/s 44AB of the act if assessee opt for presumptive taxation scheme u/s 44AD or 44ADA of the act. And there is no amendment for changing threshold limit for tax audit.

Section 44BB & 44BBB : Preventing misuse of Presumptive Schemes

Section 44BB of the Act provides for presumptive scheme in the case of a non-resident assessee who is engaged in the business of providing services in connection with prospecting for, or extraction or production of, mineral oils.

- Section 44BBB of the Act provides for presumptive scheme in the case of a non-resident foreign company who is engaged in the business of civil construction, erection, testing or commissioning in connection with a turnkey power project approved by the Central Government.

- Needless to say, the Sections were introduced to simplify the tax regime for non-residents engaged in businesses specified therein. Sub-section (3) of Section 44BB and sub-section (2) of Section 44BBB provide relief to the assessee to offer income lower than that mandated in the respective sections, in case the assessee maintains books and has actually earned income lower than what is mandated to be offered.

- However, the Sections have been subject to misuse. Taxpayers opt in and opt out of presumptive scheme depending on the amounts of income actually earned, regardless of the fact whether they factually maintain books. In a year when they have loss, they claim actual loss as per the books of account and carry it forward. In a year when they have higher profits, they opt for presumptive scheme and set off the brought forward losses from earlier years. This has led to tax evasion by misuse of the provisions, in contrast to the intent of the legislature.

- To avoid such misuse, it is proposed to insert a new sub-section to each of these sections section 44BB and to section 44BBB of the Act to provide that, where an assessee declares profits under presumptive scheme for any previous year then set off of unabsorbed depreciation and brought forward loss shall not be allowed to the assessee for such previous year.

Section 79 : Relief to start-ups in carrying forward and setting off of losses

Section 79 of the Act restricts carrying forward and setting off of losses in cases of companies, other than the companies in which the public is substantially interested. It prohibits setting off of carried forward losses if there is change of more than 51% in shareholding.

- However, some relaxation has been given to eligible start-up in case of losses. The government through aims to empower start-ups to grow through innovation and design. And hence tax exemption under section 80 IAC has been provided. Wherein, entity is consider as start-up up to 10 years from the date of its incorporation.

- However, losses incurred, by an eligible start-up companies, during the period of 7 years beginning from the year of its incorporation are allowed to be carried forward and set against the income of subsequent years irrespective of changes in voting power, provided all the shareholders of the company as on the last day of the year, in which the loss was incurred, continue to hold those shares on the last day of the previous year in which the loss is set off.

- In order to align the provision for start-ups and give proper benefit across, it is therefore proposed to amend the proviso to sub-section (1) of section 79 of the Act so that the carried forward loss of eligible start-ups shall be considered for set off , if such loss has been incurred during the period of ten years beginning from the year in which such company was incorporated.

Conclusion

Some of the above proposals would benefit small tax payers, some would punish the defaulting tax payers. Nevertheless, the targeted impact of a tax proposal depends upon its effective implementation. In that sense, some of the provisions are yet to test the waters. We will have to wait and watch.

Any differing views/ comments on the article are welcome.

◆◆◆