Direct Tax Recommendations for Budget 2024

The much-anticipated Union Budget 2024, under the Modi 3.0 government, will be presented on 23 July 2024. Globally, various stakeholders are keenly awaiting what's in store in this year's budget.

We have enumerated certain recommendations that the government may consider to simplify and streamline regulations for both businesses and individuals from a direct tax perspective.

Simplifying Valuation under Different Regulations

The issue of shares and securities by closely held companies falls under Section 56(2)(viib) of the Income Tax Act, 1961 (the Act). Rule 11UA prescribes the method of valuation for these securities. Besides income tax, the issuing company must comply with the Companies Act, SEBI, and FEMA regulations, especially when dealing with non-resident investors.

Each regulation has its own valuation methods, eligible valuers, and report recency requirements. When the subject matter of valuation remains the same, i.e., shares/securities, it is worthwhile to consider aligning the valuation rules across all regulations. This is one step towards ease of doing business.

Streamlining Capital Gains Tax Provisions

Various stakeholders have been requesting this over the years. The current provisions of capital gains taxation under the Act are separate for multiple asset classes with varying tax rates and holding periods (12/24/36 months). The indexation benefit is applicable only to long-term assets other than listed securities, and separate tax provisions exist for residents and non-residents, as well as Indian and foreign companies.

Often, investments in India as a non-resident are more lucrative than investments as a resident. We believe simplifying these provisions could significantly reduce tax arbitrage opportunities and round-tripping transactions.

Revising TDS Provisions

The existing Tax Deduction at Source (TDS) provisions have separate sections for different types of payments with varying thresholds and rates based on the taxpayer's status (individual/HUF/domestic company/foreign company). Combining sections like interest and dividend with a single higher threshold limit and unified rate for residents could simplify compliance. Likewise, payments to a contractor or a professional can also be combined in a single section with a higher threshold.

The essence of TDS provisions is to ensure that payments made do not go unreported and tax on such payments is deducted and deposited in a timely manner. This purpose can be achieved even by simplifying the TDS provisions.

Simplifying Surcharge Structure

The government may consider lowering the highest surcharge rate to reduce the effective tax rate. The provisions on the applicability of surcharges can also be simplified (for instance, the surcharge on capital gains and other income).

Besides, it is important to address the transition from one surcharge slab to another, considering that the current provisions do not actually benefit as the incremental income earned is often expended towards increased surcharge.

Enhancing Presumptive Income Tax

Raising the presumptive tax rate for businesses (8%/6% under Section 44AD) is necessary as the current rates are unrealistic. Many taxpayers misuse lower rates under Section 44DA. The rate should reflect realistic business returns, considering borrowing costs and investment alternatives.

Reducing the Effective PIT Rate

India's personal income tax (PIT) rate of 42.74% is among the highest globally. When combined with GST, the overall tax burden is substantial. The government may consider lowering the effective PIT rate to around 25%, similar to new manufacturing companies. This is especially relevant since many deductions are no longer available.

Furthermore, a very high effective tax rate encourages individuals to resort to tax planning, diversion of income at source, formation of multiple entities, etc., to reduce the effective tax liability. These practices can be kept under check if the effective PIT rate is much lower.

Raising Outdated Threshold Limits

Many threshold limits have been continuing under the Act for a long time. It is important to raise them to realistic levels. For instance:

- Standard deduction for salaried earners can be raised from INR 50,000 to INR 125,000;
- Deduction for interest on housing loan can be increased from existing INR 200,000 to INR 500,000;
- Deduction under Section 80C be kept based on income slabs;
- Threshold for reporting assets and liabilities in Schedule AL of the income tax return can be raised from INR 5 million to INR 20 million;
- Exemption from tax long-term capital gains (LTCG) from INR 100,000 to INR 150,000. A similar exemption can also be introduced for short-term capital gains (STCG) to encourage retail investors to participate in the market; and
- TDS threshold for interest and dividends can be raised from INR 5,000 to INR 15,000.

Incentivizing Green Energy and Electric Vehicles

The green energy sector is an upcoming sector considering the global unfavorable climate changes. The government may consider introducing tax benefits for entities and individuals investing in green energy.

Corporate tax benefits may include incentivizing capital investments in the green sector (i.e., building manufacturing and charging facilities) by measures such as classification of such investments as 'infrastructure facility' under Section 80-IA of the Act or incentivizing companies engaged in renting green equipment/electric vehicles.

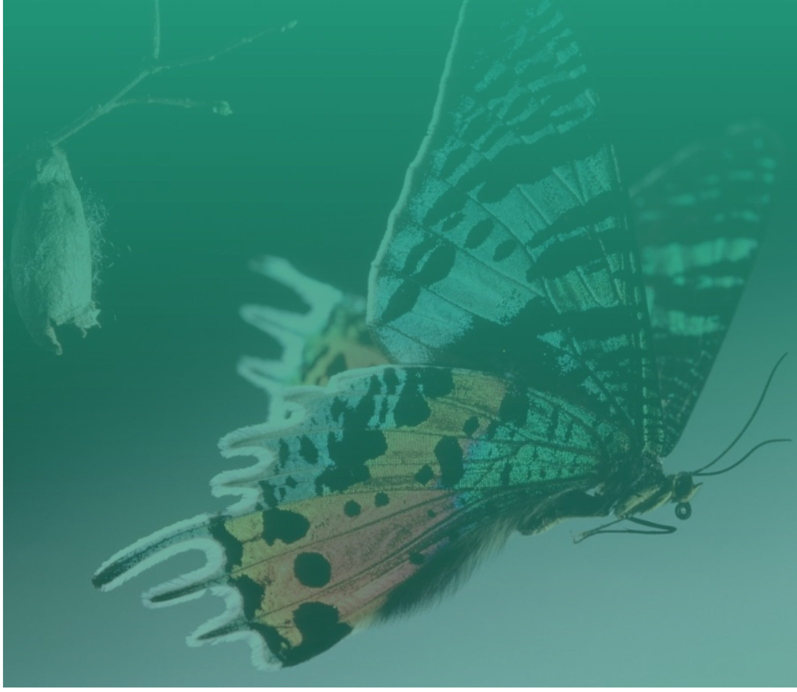
Individual tax benefits may include encouraging individuals to shift to green equipment, electric vehicles and installing charging facilities. Currently, Section 80EEB of the Act provides for a deduction to individuals of up to INR 150,000 for interest on loans taken to buy an EV. This is a very restricted benefit. The scope of the benefit may be expanded (i) to cover individuals as well as small businesses, professions, trusts, etc. (ii) for the next five years (iii) under the default tax regime and (iv) regardless of the manner of purchase – by loan or self-financing.

Ease of Compliance

- Forms AIS, TIS, and 26AS may be combined into a single form. This will reduce the mismatch between the forms and the necessity for reconciliation for taxpayers.
- Currently, entities are required to report separately under different regulations (income tax, company law, FEMA, labor laws, industry-specific laws, etc.) with different deadlines. This can be cumbersome for SMEs, startups and foreign companies. It would be worthwhile to consider single window reporting for such entities having turnover/profits below a certain threshold.
- Income tax forms can be modified to encourage taxpayers to disclose gifts received (in cash/kind), akin to disclosure of exempt income. This might reduce the possibility of litigation in the future when the department questions the source of funds.
- Tax officers may be encouraged to reduce procedural errors under faceless assessment, such as not mentioning DIN, issuing time-barred notices, notices on a nonexistent entity, etc. Recently, many decisions have been rendered in favor of the taxpayer.

Concluding Remarks

While tax regulations are complex and cannot be overhauled overnight, the recommendations made here can be incremental steps towards simplification of tax laws and ease of doing business in India.



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