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India announces its budget proposals for 2022-23

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When India's Finance Minister rose before the Lok Sabha (House of Commons) on 1st Feb, 2022 to present her budget for India's fiscal year 2022-23 (April 1, 2022 to March 31, 2023), she compressed the 284 page budget document into a crisp 90-minute speech, a part of which highlighted how India's proposed budgetary tax measures for 2022-23 fit in with the government's vision of providing a trustworthy tax regime, leading to simplification of the tax system, voluntary compliance by taxpayers, and reduction in litigation.

Simplification of the tax system remains a tall order for the Indian government. In a 2020 ranking[1] of tax complexity for 69 jurisdictions, India ranked 65th in overall complexity. India's depreciation, GAAR and capital gains regime were ranked at No 69 as the most complex in the world. Unfortunately, none of these were addressed in the budget.

The Indian government's declared policy is a stable and predictable tax regime – in furtherance to this policy, apart from introducing a slew of reforms such as faceless audits and appeals, abolition of the Authority of Advance Rulings, introduction of dispute settlement schemes such as Vivad-se-Vishwas in successive budgets since 2014, the government also legislated the withdrawal of retrospective transfer tax which was introduced by the Government in 2012, pursuant to the famous Vodafone case. As a consequence of this, as per news reports[2], almost USD 15 billion (INR 1.1 lakh crores) worth of demand was withdrawn by the Government.

However, India's government is no exception to the financial crunch governments the world over have been reeling under, since the Covid crisis of 2020. All governments are looking at newer or expanded sources of income. In this endeavor, the Indian budget provides a scheme for taxation of crypto-currencies with effect from April 1, 2022. Further, in order to be able to effectively capture such transactions, the Finance Bill has imposed a withholding tax obligation on the person responsible for making the payment to the resident. There are only a handful of businesses in India which currently accept crypto currencies as payments – cryptos are largely used for investments in India. To that extent, the taxation may not pose challenges such as those seen in countries where cryptos are widely accepted by businesses as payments.

The budget proposes measures to attract foreign investment in India, such as increased exemptions for income from operations in India's International Financial Services Center, extension of timelines for eligibility to claim start-up status and to claim tax benefits for newly incorporated manufacturing entities. It also proposes to overhaul India's Special Economic Zone regime[3].

The budget also proposes an overhaul of the tax exemption system for charitable trusts and institutions, arguably one of the most abused tax exemption schemes in the Indian tax code. The proposed overhaul shall bring greater transparency and accountability together with penalties for passing on unreasonable benefits to trustees or specified persons, serving as a deterrent.

Continuing with the past trend, several modifications have been introduced in the Income-tax Act where Courts have given rulings in favour of taxpayers. As an example, in various judgements, Indian courts have held that in case assessment is made on a predecessor entity which loses its existence due to the amalgamation or merger, it shall be considered as invalid. The law has been proposed to be amended to make such assessments valid by deeming it to have been made on the successor entity. This will apply prospectively. Pursuant to rulings in favour of the taxpayer, the law has been proposed to be amended to provide that surcharge and cess paid on income-tax is no longer deductible business expenditure. This change is retrospective. In another example, several Courts had held that conversion of outstanding interest to debentures shall be treated as payment of interest and would be tax deductible – the law is proposed to be amended to provide that henceforth such conversions are not tax-deductible payments.

The budget contains over two dozen proposals to facilitate widening and deepening of the tax base, mobilizing revenue and rationalizing the tax base. As we will discuss in a later blog, some of these proposals may actually create more litigation and uncertainty for taxpayers in India.

Overall, on the direct tax front, India's budget is largely focused on procedural changes with an attempt to plug loopholes and expand its tax base.

[1] https://www.taxcomplexity.org

[2] https://www.hindustantimes.com/business/govt-to-refund-rs-7-900-crore-retro-tax-to-cairn-company-to-withdraw-cases-101637235754715.html

[3] India's SEZ regime which included a host of tax & regulatory relaxations for businesses operating in areas designated as SEZs saw tremendous success in boosting the country's export earnings. Investments in SEZs went up from USD 631 million in 2005-06 to USD 80,731 million in 2019-20.

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