BCC&I
THE BENGAL CHAMBER

POST BUDGET MEMORANDUM 2020 ON DIRECT TAXES

Sl. No.	Section/Subject	Issue	Rationale with factual data	Recommendation
1	Personal Tax Rates	a)The tax rates at different slabs have been tweaked for income upto Rs.15 lacs. However, the tax rate reduction is linked to a large number of conditions, including subscription to various small savings schemes, which would definitely result in impacting them in addition to the resultant complexity. For example in order to be eligible for lower rate one cannot claim standard deduction, House Rent Allowance, section 80C deduction like LIC and PPF etc. b)The personal tax rates above Rs.15 lacs continue as before. In the process, the difference between the said rates and that for Corporates have increased sharply.	a)Beside limited net gain to the taxpayer due to removal of exemptions, the new regime would add huge complexity for small taxpayers who would require services of tax consultants for evaluating the best option applicable for them. b) This has resulted in a major structural issue whereby, small businesses which are proprietary in nature or, are constituted as firms, will be required to pay tax @ 30% plus applicable surcharge and cess, whereas for those constituted as companies, the tax rate will be appreciably lower @ 22% plus surcharge and cess. It is estimated that the total number of corporate taxpayers is less than 8.5 lacs and provide employment to less than 20% of the industrial work force. However, proprietary businesses and firms (taken together) is roughly estimated in numbers as more than 5 crores and employ 80% of the work force. Therefore, it can be stated that there would have been a surge in consumer spending and employment if tax cuts were given to non-corporate tax payers in the Budget.	a)It would have been better if the tax rate reduction was done, to whatever extent possible, without any conditions. This in turn would have resulted in boosting consumption by giving more money to the common man and also not affecting the small savings schemes. b)As such, the Government should consider giving a tax cut for individuals and firms, which would give a boost to spending and employment.

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2	Dividend Tax	This year, the Budget has shifted the incidence of Dividend Taxation by removing Dividend Distribution Tax and levying it in the hands of the recipient.	In addition to the earlier issue of whether the dividends can be taxed at all or not, since a company's profits are already subject to tax and this is a posttax distribution to shareholders, this tax will imply taxation at the highest rate possible dependent on recipient's income. The earlier tax relief upto Rs.10 lacs also stands withdrawn. Further, this will also impact domestic investors more than foreign investors since Tax Treaties provide for lower rates of tax on dividend income for them.	There is definitely a need to consider a lower rate of tax on dividend income in the hands of the shareholder, without linking the same to the tax slab of the recipient. Moreover, the provisions for not allowing any expenses against such dividend income other than interest to the extent of 20% of dividend income is an extremely arbitrary and unfair restriction and should be removed.

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3	Taxing of Employer's contribution to NPS, Provident Fund and Superannuation Fund beyond Rs.7.5 lacs as well as the interest on the Employer's contribution above Rs.7.5 lacs.	The Budget has imposed tax on employees in respect of Employer's contribution to NPS, Provident Fund and Superannuation Fund beyond Rs.7.5 lacsalongwith the related interest on the said taxable amount.	These are meant for social security of employees and therefore of a very critical nature for taking care of their post-retirement period. Further, contributions made by the employer to Superannuation Fund do not accrue to the benefit of the employee till such time he retires upon superannuation, when the Fund is used to purchase annuities and/or to pay the commuted pension to the retired employee. Such contributions may or may not result in superannuation benefits to the employees since there are various conditions to be fulfilled by the employees like serving a stipulated number of years, reaching a certain age etc. Therefore, this contingent benefit should not be taxed as perquisite as per the ratio of decision laid down by the Hon'ble Supreme Court in **CIT vs. L W Russel [2002-TIOL-686-SC-IT]**. Further, the pension payments are subjected to tax at the time of actual receipt by the employee.	As such, it is suggested that Employer's contribution to retirement funds like provident fund and superannuation fund should not be taxed as perquisite. Also, the concerned interest in respect of the differential amount above Rs.7.5 lacs should not be taxed.

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4	Valuation of company owned accommodation provided to employees	As per the current Income Tax Law, company owned accommodation provided to employees is taxable @ 15% of salary in cities having population exceeding 25 lakhs. In other cases, it is taxable @ 10% of salary in cities having population between 10 lakhs and 25 lakhs and 7.5% of salary in other places. In case of leased / rented accommodation, value of the accommodation is taken at the stipulated percentages or lease rent, whichever is lower.	The method of determination of the perquisite suffers from various inequities. For example, for the same employee staying in the same company owned accommodation, the perquisite will increase with any salary increase. Again, for the same company owned accommodation, different employees with different salaries will have different perquisite value. Also, irrespective of the size/quality of company owned accommodation, the perquisite for a particular employee will be determined as a percentage of salary.	It is suggested that in case of company owned accommodation, the concept of fair rental value should be re-introduced to ensure that the right amount of perquisite is determined for income tax purposes. The fair rental value should be defined as the rent which similar accommodation would realize in the same locality or, as prescribed by CBDT. The stipulated percentages for determination of the perquisite value as mentioned in the earlier column, may be continued, but the same should be capped at the fair rental value.

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5	TCS under section 206C for sale of goods.	The Budget has introduced a new provision for 'Tax Collection at Source' (TCS) @ 0.1% of the sale consideration in respect of sale of goods if it exceeds Rs.50 lacs in any year. This is applicable if the seller "*receives any amount as consideration for sale of any goods*".	(a)This will result in making business transactions extremely complex and militate against the professed philosophy of bringing about "ease of doing business" in India. The consequential administrative impact in terms of record keeping, TCS adjustment/payment of tax refunds etc. will be massive. (b)Even otherwise, the new provision requires the applicability of TCS in respect of realization / receipt of any amount as consideration for sale of goods.	(a)It is suggested that this be withdrawn. (b)The law requires collection of TCS only on receipts. Therefore, if the sale value is outstanding/sold on credit, TCS should be collected and deposited only on realization. Further, in respect of advances received, TCS should be applicable only when invoice is raised and the amount is appropriated towards it. The above should be clarified.

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6	TCS under section 206C for remittance out of India exceeding Rs.7 lacs in aggregate under the "Liberalized Remittance Scheme" of the Reserve Bank of India and also in respect of purchase of tour packages from the seller of an overseas tour program.	The newly introduced provision requires TCS @ 5% on the remittance to be done by the authorized dealer in respect of the buyer of the foreign currency. This tax collected by the Government is in respect of post-tax funds of the party and this can be claimed later when the return is filed. The said provision on TCS will also be applicable in respect of seller of an overseas tour program who receives any amount from the customer.	These will result in increase of compliance cost and money will also be tied up in the refund process. There is no clear justification for the said fall-outs in the absence of any specific reason that the liberalized remittance scheme is being misused on a large scale or, travelling abroad is a crime. In fact, this would be a throw back to the pre-reform era when foreign currency leaving the country was seen as a problem and numerous restrictions were imposed to stem the flow. In those days, preservation of India's stock of hard currency was seen as a priority but the said situations do not exist any more. The above measures will surely have a negative impact on businesses.	The Government should consider withdrawing the said measures for imposing TCS on remittances and foreign tours.

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7	TDS on e-commerce	The Budget has introduced a new provision for TDS @ 1% on the supply of goods or services to be done by the e-commerce operator on the supplier.	The TDS provisions are extremely cumbersome anyway. E-commerce is going through birth pangs in the current period.The introduction of TDS will result in extreme complexity and related difficulties in terms of record keeping, tax payment, tax refunds etc.. In fact, this will also be detrimental to the digitalization of the Indian Economy and potential employment generation. There could also be some instances of penetration pricing because of lesser overheads and there may not be any profits and this worsens the TDS applicability.	It is recommended that this be withdrawn.

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8	Taxing of ESOPs in the hands of the employees for companies other than start ups.	The current Income Tax Law, provides for the inclusion of ESOPs under section 17(2) to be taxed as a "*perquisite*", consequent to the abolition of FBT. The section states that ESOPs issued free of cost or at concessional rates will be taxed on the date of exercise on the difference between the "*fair market value*" and the amount actually paid by the employee. The "*fair market value*" is to be determined based on stipulated methods which have been separately prescribed by the CBDT. In this year's Budget, necessary relief has been given for start ups but not for other companies with turnover exceeding Rs.100 crores.	Existing law on ESOP taxation suffers from the following drawbacks : (a)It seeks to tax a notional benefit at a time when the actual gain is not realized by the employee. In fact, it is possible that the actual sale of shares could result in a loss for the employee. Since the perquisite tax paid earlier cannot be set off against the capital loss, the employee suffers a double loss, namely tax outgo and loss on sale of shares. (b)The question whether the ESOPs are granted at a concessional rate is being determined with reference to the "*fair market value*" on the date of exercise of the options. Technically, this is an incorrect approach. If the ESOPs are issued at the prevailing market price on the date of grant, the issue should be treated as "*non concessional*". This would be in line with the guidelines issued by SEBI. Any subsequent gain accruing to the employee due to favourable market movements by the date of vesting or exercise of option cannot be treated as a "*perquisite*" granted by the employer. (c)Further, if such subsequent gains are a perquisite in the hands of employers, it would stand to reason that the value equivalent of such a perquisite should have been a deductible expenditure in the hands of the company issuing the ESOP. Since the tax law does not contemplate such a deduction, the taxation of the perquisite would result in double taxation.	After considering the recommendation submitted earlier, the Government has incorporated necessary tax relief in section 192, for eligible start ups with turnover upto Rs.100 crores whereby the perquisite tax has been deferred to the following : - After 48 months or - Date of sale or - Date of cessation of employment whichever is the earliest. It is recommended that the above tax relief should be extended to employees of all companies, instead of restricting it only to start ups. This will go a long way in fostering an enterpreneural spirit

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	Taxing of ESOPs in the hands of the employees for companies other than startups ***….contd. from previous page***		Also, from the strictly legal angle, there are a number of differences between ordinary shares and ESOP shares. Therefore, they are not comparable. The taxation principles currently existing, result in discrimination. The market value is also strictly not applicable since there are lock-in periods applicable. A detailed note on these aspects is enclosed (**Annexure 1).** Since the actual sale of shares will attract capital gains tax, if applicable, it is unnecessary to subject the employee to perquisite tax. In fact, before FBT was imposed on ESOPs, specific provisions existed in the Income Tax Act for exempting the same from perquisites and subjecting it only to capital gains tax. It may be noted that ESOPs have emerged over the years as a critical, motivational and retention tool for companies in a highly competitive market for talent. It is a very effective instrument for encouraging employees to perform and excel and is a win-win proposition for the employers / shareholders on one hand and the employees on the other.	

Annexure 1

ESOP shares vis-à-vis Market Shares

They are not comparable

1. ESOP shares are "issued" by the employer and "subscribed" to by the employee, whereas the shares acquired in the market ("market shares") are "transferred" from one shareholder to another. Consequently, while the market shares are goods, the ESOP shares do not become goods until they are allotted in favour of the subscribing employee.

2. It follows that the ESOP shares are not comparable with the shares that are already being traded. Therefore, it is incorrect to quantify any benefit to the employee with reference to the already trading shares or their so-called market value.

3. Even after allotment of the ESOP shares, the employee is prevented by law or the terms of the grant, from selling the shares during a lock-in period, whereas the shares bought in the market can be sold immediately without any restraint. The legal ability of disposition being one of the essential attributes of "property", the ESOP shares, unlike the market shares, are not property in the hands of the employee even after allotment.

4. When on the date of exercise the shares are subject to a lock-in condition, they cannot be considered to be a benefit; and if it is a not a benefit, it ought not to be fictionally treated as benefit and brought under "perquisites". In ***CIT v. Infosys Technologies Ltd.,(2008) 2 SCC 272*, at page 277**, the Supreme Court held as follows:

   "During the said period, the said shares had no realisable value, hence, there was no cash inflow to the employees on account of mere exercise of options. On the date when the options were exercised, it was not possible for the employees to foresee the future market value of the shares. Therefore, in our view, the benefit, if any, which arose on the date when the option stood exercised was only a notional benefit whose value was unascertainable. Therefore, in our view, the Department had erred in treating Rs.165 crores as perquisite value being the difference in the market value of shares on the date of exercise of option and the total amount paid by the employees consequent upon exercise of the said options."

   The Court further, at page 279, held:

   "It is important to bear in mind that if the shares allotted to the employee had no realisable sale value on the day when he exercised his option then there was no cash inflow to the employee. It was not possible for the employee to know the future value of the shares allotted to him on the day he exercises his option."

It may be borne in mind that in the Infosys case, the Supreme Court dismissed the Government's appeal not only because the ESOP shares were not enumerated under "perquisites" in S. 17 (2), but also because it does not amount to a benefit.

5. For this reason also the ESOP shares and the market shares are not comparable, and the latter cannot afford any basis for determining any benefit that may have accrued to the employee on account of the ESOP shares.

Discrimination

6. When a listed company issues IPO or rights shares at a price less than the market value (or bonus shares), the difference between the issue price and the market price is not taxed. If in such a case the difference does not take the character of income, it cannot be income in the case of ESOP shares too.

7. And, if such difference (in the case of IPO/rights/bonus) does take the character of income, then taxing ESOP share alone lacks any intelligible differentia that can validly explain this classification.

8. If a distinction is suggested on the ground that in the case of ESOP shares the benefit takes the character of income from salaries (which is apparent from treating it as "perquisite") which is not so in the case of market shares, it would be incorrect because such income, especially in the nature of salaries, would flow to the employee only when he realizes a gain upon the sale of the shares and not by mere allotment. Therefore, this is not a meaningful distinction.

Valuation

9. The "market value" is taken as on the date of exercise. But the ESOP shares are allotted after a lapse of time, when the market value may not be the same.

10. Even the market value on the date of allotment would not be relevant because the employee would not be able to realize that "value", being prevented from selling the ESOP shares during the lock-in period.

11. Further, the issue of ESOP shares results in expanding the capital base, and a consequent reduction in the intrinsic value of the existing shares. For this reason also, the alleged benefit flowing from ESOP shares cannot be reckoned with reference to the current value of the already existing market shares.