

# Budget 2021

## ANALYSIS OF THE CHANGES BY FINANCE ACT 2021





### **Analysis of the changes made in the Finance Act, 2021:**

The Finance Bill, 2021 as presented originally on 1<sup>st</sup> February, 2021 has been enacted with more than 100 changes. There are certain new amendments and some of the originally proposed amendments have been modified.

Some of the important changes have been summarised below:

#### **Taxation on dissolution or reconstitution of Firms / AOP / BOI:**

As per the Finance Bill, 2021 originally presented, new section 45(4A) was proposed to charge excess of amounts and other assets over capital balance received by partner on dissolution or reconstitution as capital gains.

The Finance Act, 2021 has omitted the above proposed section and introduced a new deeming fiction under section 9B. It provides that receipt of any capital asset or stock-in-trade or both by a partner from a firm in connection with the dissolution or reconstitution of the firm shall be treated as deemed transfer by the firm. It will be taxable in the year of receipt of such capital asset or stock-in-trade by the partner, as capital gains or business income, as the case may be.

The fair market value of the capital asset or stock-in trade on the date of its receipt by the partner shall be adopted as the full value of consideration in computation of taxable amount. The section also defines the term “reconstitution” in the context of Firm/ AOP/BOI, which includes change in profit-sharing ratio.

### **Taxation of receipts of money or capital asset by partner in connection with reconstitution of firm:**

The Finance Act, 2021 has substituted section 45(4). The section provides for taxation of any money or capital asset or both received by the partner in excess of balance in his capital account, on account of reconstitution of the firm. The section prescribes a formula for computing the taxable amount. The amount will be taxed in the hands of the Firm/ AOP/BOI as capital gain. It is also clarified that the provisions of section 45(4) will be applicable in addition to the provisions of section 9B.

#### **CNK Comments:**

The ambiguity surrounding the earlier proposed sections 45(4) and 45(4A) has been addressed to an extent with the introduction of section 9B, and withdrawal of the earlier proposed section 45(4A). Section 9B, provides for taxability in the event of dissolution or reconstitution and section 45(4) covers only reconstitution. Thus, section 45(4) does not cover dissolution.

#### **Amendment to Section 48:**

Section 48 allows certain deductions in computation of capital gains. An additional deduction is allowed on transfer of a capital asset in respect of the capital gains charged to tax under section 45(4). A part of capital gains taxed under section 45(4) will be reduced from the full value of consideration of the capital asset being transferred by the firm. Only such proportion of the income taxed under section

45(4) which is attributable to the capital asset is to be deducted, and the manner for such attribution will be prescribed by the CBDT.

#### **Depreciation on Goodwill:**

The Finance Bill, 2021 as originally presented, proposed to prohibit the allowance of depreciation on goodwill existing as on 31<sup>st</sup> March 2020 and any new good will acquired on or after 1<sup>st</sup> April 2020. However, there was no clarity as regards the reduction of goodwill which was already part of the block of assets, especially in a scenario where the block included other intangible assets as well. The Finance Act, 2021 has amended section 43(6)(c) to provide that WDV of the block of assets shall be reduced by the WDV of goodwill falling within such block of assets.

The actual cost of such goodwill shall be first decreased by:

- a. The amount of depreciation actually allowed to the assessee on such goodwill before the AY 1988-89 and
- b. Amount of depreciation that would have been allowable to the assessee from the AY 1988-89 till AY 2020.21 as if such goodwill was the only asset in the relevant block of assets.

The Finance Act, 2021 has also provided that the above reduction of WDV of goodwill shall not exceed the WDV of the block of intangible assets.

#### **CNK Comments:**

This clears the ambiguity surrounding the treatment of goodwill already existing in the block of assets. As the amendment is effective

from 1 April 2021, this exercise of carving out the WDV of goodwill would need to be undertaken for computing the tax payable for FY 2020-21. It is important to note that the WDV of the block of intangible assets is to be computed in the prescribed manner only if the block contains goodwill as on 1<sup>st</sup> April 2020 and would not apply in a case where the goodwill has been transferred prior to the date,

#### **Tax on interest earned on PF contribution exceeding INR 2,50,000 or INR 5,00,000**

Presently, any interest on the contribution made by the employees to statutory provident fund, recognised provident fund and public provident fund is exempt from tax.

The Finance Bill 2021 as originally presented proposed that no exemption will be available for the interest accrued during the previous year in the recognised provident fund and statutory provident fund to the extent it relates to contribution made by the employees in excess of INR 2,50,000 in a financial year. Further, rules were to be prescribed to compute the taxable component of such interest.

The Finance Act, 2021 has inserted a second proviso to section 10(11) & section 10(12), stating that if an employee is contributing to the fund, but there is no contribution from the employer, then accrued interest shall be taxable to the extent it relates to contribution made by the employee in excess of INR 5,00,000 in a financial year.

**Non-account payee cheque / draft transactions to be considered as cash transactions for the purposes of tax audit:**

The Finance Bill, 2021 as originally presented proposed to raise the threshold limit for getting books of accounts audited under the Act to INR 10 crore from INR 5 crore, in cases where the cash receipts and payments made during the year do not exceed 5% of the total receipts and payments, respectively.

The Finance Act, 2021 provides that for the computation of threshold of INR 10 crore, the payment or receipt settled through a non-account payee cheque / draft shall be deemed to be cash payment or cash receipt, respectively.

**Taxability of transfer of undertaking:**

The Finance Bill, 2021 as originally presented amended section 2(42C) to provide that all types of transfer as defined u/s 2(47) shall be covered within the ambit of slump sale.

The Finance Act, 2021 has amended section 50B to provide that the fair market value of the capital assets on the date of transfer shall be considered as the full value of consideration. The manner for computation of such fair market value shall be prescribed.

It is further provided that the value of capital asset being goodwill which has not been acquired by way of purchase from previous owner, shall be considered as nil in computing net worth.

**CNK Comments:**

While the amendments proposed in the Finance Bill only covered transactions of transfer of undertakings by means other than sale, such as slump exchange, the amendment in the Finance Act, deeming fair value of the undertaking as the consideration, would have an impact for all situations relating to transfer of undertaking including slump sale. While the amendments are applicable with effect from AY 2021-22 i.e. FY 2020-21, the amendment relating to the deemed consideration may not have an impact in FY 2020-21 as the method has not been prescribed on or before the 1<sup>st</sup> day of the assessment year (1<sup>st</sup> April 2021) and hence the section may be considered as inoperable until such time as the method is prescribed. It is expected that the method to be prescribed for computing the fair value of capital assets in the undertaking transferred would be similar to the existing Rule 11UA which provides for the net book asset value (except in case of certain assets) to be the fair value of shares transferred.

Moreover, unlike other provisions in the Act which deem the higher or fair value or actual consideration to be the consideration for the purposes of computation of capital gains, the amendment in section 50B only deems the fair value of the assets to be the consideration. Therefore, the question arises as to whether one may be able to argue that the fair value should be the consideration for computing capital gains even if the actual consideration is higher than such fair value as computed in the prescribed manner. One may need to wait for the method to be prescribed in this aspect before taking a position on the above issue.

The amendment relating to exclusion of goodwill from the assets for computing net worth and the cost of acquisition of the undertaking transferred, does not apply if the goodwill has been acquired by way of purchase. While acquisition of business including goodwill may be considered as acquisition by way of purchase, in case the undertaking sought to be transferred is acquired by way of an amalgamation, the amalgamation may not be considered as acquisition by way of purchase.

#### **Taxation of proceeds of high premium unit linked insurance policy (ULIP):**

The Finance Bill, 2021 as originally presented proposed that exemption u/s 10(10D) would not be available to ULIPs issued on or after 01.04.2021, if the amount of premium payable for any of the previous year during the term of the policy exceeds INR 2,50,000/-. The income arising from such high-premium ULIPs was to be made taxable u/s 112A. Accordingly, the definition of equity-oriented fund was proposed to be amended to cover the high premium ULIPs. The equity-oriented fund to cover the high premium ULIPs if it invests minimum 90% (in case of investments in units of funds listed on a recognised stock exchange) or 65% (in any other case) in equity shares of a domestic company.

The Finance Act, 2021 has inserted a second proviso, stating that the minimum requirement of 90% or 65%, as the case may be is

required to be satisfied throughout the term of such insurance policy.

#### **Amendment in computation of book profit for foreign companies:**

The Finance Bill, 2021, as originally presented, proposed that in the case of an increase in the book profit of the previous year on account of earlier years' profit due to an advance pricing arrangement or secondary adjustment, the assessee could, on making an application seek to amend the book profits of the relevant years. The Finance Act, 2021 has clarified that such an adjustment to the book profit of earlier years can be undertaken only if the assessee has not utilised the MAT credit. Further, the Finance Act 2021 has also clarified that this provision of recomputation of book profits shall also be available for earlier assessment years and no interest shall be receivable in case of any refund determined in accordance with the above provisions.

#### **Fee for default in furnishing return of income:**

The Finance Bill, 2021 proposed to reduce the time-limit to furnish revised or belated returns of income to 31<sup>st</sup> December of the relevant AY. Section 234F, prior to its amendment provided for a higher late fee of INR 10,000/- if the return of income was filed after 31<sup>st</sup> December of the AY. This is infructuous with reduction of the time-limit to furnish a belated return of income to 31<sup>st</sup> December. Thus, the Finance Act, 2021 has made the consequential amendment to section 234F providing that late filing fee shall be

INR 5,000/-. However, in cases where the total income of a person does not exceed INR 5 lakhs, the fee payable shall be INR 1000/-.

#### **Fee for default in linking Aadhar & PAN:**

The Finance Act, 2021 has introduced new section 234H to levy a fee for default in intimating the Aadhar Number.

As per section 139AA, it is mandatory for every person to link his PAN with the Aadhar number. On failure to do so, the PAN allotted to the person shall be made inoperative. In addition to this, such person will now be liable to pay a fee of INR 1,000 at the time of making such intimation.

#### **Changes related to Procedures under the Act:**

##### **Time Limit for submission of belated & revised returns:**

The Finance Act has redrafted the wordings for the amendments proposed by the Finance Bill, 2021 to align with the intention. Thus, it is provided that the belated and revised return can be filed before three months prior to the end of the relevant Assessment year or completion of assessment, whichever is earlier.

##### **Amendments related to new scheme of reassessment procedures:**

The Finance Bill 2021 had proposed a new scheme of reassessment of income in respect of search & seizure cases. The Finance Act, 2021 has included re-computation of income in the scope of the explanation to new section 147 as introduced by the Finance Bill, 2021.

#### **Amendments related to Settlement Commission:**

The Finance Bill, 2021 proposed to discontinue the Settlement Commission w.e.f 01.02.21. In case of applications already filed, the assessee had an option to withdraw the same within 3 months from the date of commencement of the Finance Act, 2021. In case the assessee failed to withdraw the application, the same will be deemed to be received by the Interim Board.

The Finance Act, 2021 has now provided that if the assessee exercises the option to withdraw the application before the settlement commission, the period of limitation available to the Assessing Officer for making an assessment, reassessment or recomputation after the 'excluded time' shall not be less than one year.

#### **Definition of "Liable to Tax"**

Finance Bill, 2021 proposed to define the term "liable to tax" in relation to a person, to mean cases where there is a liability of tax on such person under any law for the time being in force in any country; and including a case where subsequent to imposition of tax liability, an exemption has been provided.

Finance Act, 2021 has amended the term "Liable to tax" in relation to a person and with reference to a country, to mean that there is an income-tax liability on such person under the law of that country for the time being in force and shall include a person who has

subsequently been exempted from such liability under the law of that country.

**CNK Comments:** The amendment has clarified that the person should have liability to “income-tax” under the law of the concerned country and not any other tax. This provision has to be read in conjunction with section 6(1A) or the relevant tax treaty.

#### **Income of a non-resident from leasing / transfer of aircraft in IFSC [Section 10(4F) and section 80LA]**

In order to further enhance the attractiveness of GIFT IFSC, Finance Bill, 2021 proposed to provide tax exemption to royalty income of a non-resident from leasing of aircraft to a unit in IFSC, if:

- The unit was eligible for deduction under section 80LA in that year; and
- The unit had commenced operations on or before 31 March 2024.

Finance Act, 2021 has relaxed the exemption provision as under:

- In addition to the above-mentioned royalty income, the tax exemption will be available for interest income from leasing of aircraft to a unit in IFSC;
- The requirement of the lessee unit in IFSC being eligible for deduction under section 80LA in the concerned year has been removed;

- The definition of the term ‘aircraft’ has been expanded to mean an aircraft or a helicopter, or an engine of an aircraft or a helicopter, or any part thereof.

Also, Finance Bill, 2021 proposed to provide income deduction / tax holiday under section 80LA to income of a unit in IFSC from transfer of an aircraft (or aircraft engine) leased to a domestic company engaged in the business of operation of aircraft (prior to such transfer), provided the unit had commenced operations on or before 31 March 2024.

Finance Act, 2021 has further enhanced the income deduction / tax holiday to cover income of a unit in IFSC from the transfer of aircraft (as per expanded definition explained above) leased to any person, provided the unit has commenced operations on or before 31 March 2024.

**CNK Comments:** This is a welcome amendment which should provide boost to aircraft leasing business in the IFSC. The amendment considers the practical aspects of aircraft leasing business where the lease may be an operating lease (resulting in rental / royalty income) or a finance lease (resulting in interest income). Hence, both types of leases should now enjoy the tax exemption. The removal of the condition that the lessee unit in IFSC should be eligible for deduction under Section 80LA should bring more transactions within the tax exemption. It may be noted that the

requirement for the lessee unit in IFSC to commence operations on or before 31 March 2024 continues.

Lastly, granting the income deduction / tax holiday under section 80LA to income of a unit in IFSC from transfer of aircraft leased to any person (not only domestic company engaged in operation of aircraft) should cover more transactions and boost such activities in the IFSC.

### **Relaxation in Equalization Levy (EL)**

Finance Bill, 2021 proposed levy of EL on not only the consideration of e-commerce operator from covered transactions but also:

- Consideration for sale of goods irrespective of whether the e-commerce operator owns the goods;
- Consideration for the provision of services irrespective of whether service is provided or facilitated by the e-commerce operator.

Finance Act 2021 has now clarified that on e-commerce operator would not be liable to EL in respect of the consideration towards sale of goods or services owned / provided by:

- Persons resident in India;
- Permanent establishment (PE) of a non-resident in India if the said goods / services are effectively connected with such PE.

CNK Comments: This is a welcome move as otherwise there could have possibly been an economic double taxation impact i.e. the non-resident e-commerce provider would have paid EL on the an amount which is liable to income-tax in India in hands of Indian tax residents or PE of non-residents in India.



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