INDIA'S BUDGET 2025-26 – DIRECT TAX PROPOSALS - KEY HIGHLIGHTS

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Introduction

India's Union Budget (the "**Budget**") was announced on February 1, 2025, and the Finance Bill, 2025 (the "**Finance Bill**") was tabled in Parliament. The Finance Bill will be discussed in Parliament before its enactment, and it is likely that it will be amended based on these discussions. Once enacted, the income tax proposals in the Finance Bill will become effective on the dates specified therein.

The Finance Minister in her Budget speech has stated that a new Direct Tax Bill will be placed in Parliament next week that will be simple and easy to comprehend for taxpayers.

We have summarized some of the key income tax proposals made in the Budget below.

Personal income tax rates

The Finance Bill has proposed the following tax regime for individual taxpayers under the Income-tax Act, 1961 (the "**IT Act**"):

S. No.	Total income	Rate of tax
1.	Up to INR400,000	Nil
2.	INR400,001 to INR800,000	5%
3.	INR800,001 to INR1,200,000	10%
4.	INR1,200,001 to INR1,600,000	15%
5.	INR1,600,001 to INR2,000,000	20%
6.	INR2,000,001 to INR2,400,000	25%
7.	Above INR2,400,000	30%

Based on the FAQ released by the Indian government on February 1, 2025, resident individuals with total income up to INR1,275,000 (Indian Rupees One Million and Two Hundred and Seventy-Five Thousand) (standard deduction of INR75,000 (Indian Rupees Seventy-Five Thousand)) will not have to pay any income tax. This amendment will take effect from April 1, 2025.

The new tax slab structure is a significant relief that will reduce taxes of the middle-income group, thereby increasing the take home pay and boosting household consumption, savings and investment.

Tax exemptions to non-residents operating in the International Financial Services Centre ("IFSC")

IFSC is a jurisdiction that provides financial services to non-residents and residents, to the extent permissible under the current regulations, in any currency except the Indian Rupee. The IT Act has, over the past few years, provided several tax concessions to IFSC units. Currently, any income that is accruing, arising or has been received by a non-resident as a result of (i) the transfer of; or (ii) distributions from, non-deliverable forward contracts, offshore derivative instruments, or over-the-counter derivatives ("**Specified Derivatives**") entered into with a banking unit set up in IFSC, is tax exempt.

The Finance Bill proposes to extend the foregoing tax exemption to the income earned by a non-resident in relation to specified derivatives entered into with foreign portfolio investors set up in IFSC. This amendment will take effect from April 1, 2025.

The foregoing changes are intended to promote the set-up of foreign portfolio investors in the IFSC.

In addition, in order to incentivize operations from IFSC, the Finance Bill has proposed the following amendments:

(a) Sunset dates: The sunset dates for tax concessions related to the commencement of operations of IFSC units and the relocation of funds to IFSC under various provisions, have been extended to March 31, 2030.

(b) Tax on life insurance proceeds: Section 10(10D) of the IT Act currently provides tax exemptions on life insurance proceeds, including the proceeds from IFSC insurance offices, subject to certain premium limits. The exemption is not available if the annual premium exceeds INR250,000 (Indian Rupees Two Hundred and Fifty Thousand) for unit-linked policies or INR500,000 (Indian Rupees Five Hundred Thousand) for other life insurance policies. The proposed amendment aims to provide better treatment to non-residents by removing the premium limit for life insurance policies issued by IFSC insurance offices. This will ensure that life insurance proceeds from such policies are exempt from tax regardless of the premium amount.

(c) Ship leasing: The tax exemptions for aircraft leasing units in IFSC on capital gains and dividends have been extended to ship leasing units in IFSC.

(d) Dividends for treasury centres: Currently, any loan or advance given by a company (in which the public is not interested) to a shareholder holding 10% or more voting power or to any business in which such a shareholder has a substantial interest, is treated as "deemed dividend" to the extent of the company's accumulated profits. Concerns were raised that corporate treasury centres in IFSC could unintentionally fall under this provision when borrowing from their group entities. A treasury centre of an entity or a group entity enables it to centralise and concentrate cash and risk management to gain economies of scale, process efficiencies, and ensure tighter control of cash flow in the group entity. The establishment of a treasury centre in the IFSC allows corporations to manage their global treasury operations such as foreign

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exchange and risk management, asset management, and advisory related to mergers and acquisitions, etc. To address the issue mentioned above, the amendment excludes loans or advances between two (2) group entities from being treated as deemed dividends if one (1) group entity is a finance company or finance unit in an IFSC set up as a global or regional treasury centre. This exemption applies only if the parent or principal entity of the group entity is listed on a foreign stock exchange, except in restricted jurisdictions specified by the tax authorities.

(e) Simplification for IFSC fund managers: Currently, fund management activity that is carried out through an eligible fund manager acting on behalf of an eligible investment fund shall not constitute a business connection in India, subject, *inter alia*, to the fulfilment of the condition that the aggregate participation or investment in the eligible investment fund, directly or indirectly, by persons resident in India does not exceed 5% of the corpus of the fund. Representations have been made highlighting the need to provide a simplified regime for IFSC based fund managers managing funds situated in other jurisdictions so that fund managers in IFSC are at par with the fund management entities in competing foreign jurisdictions. The Finance Bill has proposed amendments seeking to rationalize the foregoing condition, by providing a four (4)-month window to fulfil the condition, if the aggregate participation or investment exceeds 5% of the corpus of the fund on April 1 and October 1 each year. The Finance Bill provides that the foregoing condition will not be modified for any eligible fund and other conditions can be relaxed for funds whose managers in IFSC begin operations by March 31, 2030.

(f) Expansion of relocation regime: Currently, the relocation of funds to a "resultant fund" (i.e., alternative investment funds in IFSC) is exempt from capital gains tax. The Finance Bill has proposed to extend the tax exemption to the relocation of original funds to retail schemes and exchange traded funds ("**ETFs**") in the IFSC. The amendment will expand the definition of "resultant fund" to include retail schemes and ETFs that are regulated under the IFSC Authority Act, 2019.

The transfer of the assets of a fund (that is the original fund) or of its wholly owned overseas special purpose vehicle, subject to certain conditions, to a resultant fund in India is called "relocation." Further, a "resultant fund" means a fund established or incorporated in India to which the assets of the original fund are transferred, subject to certain conditions. The amendment (as explained above) will encourage retails schemes or ETFs to relocate to the IFSC.

The above proposed amendments will take effect from April 1, 2025.

Extension of dates for investments by sovereign wealth and pension funds in India

Currently, the sovereign wealth and pension funds are exempt from tax for income earned from dividends, interest, and long-term capital gains arising from an investment made by the sovereign wealth and pension funds in India on or before March 31, 2025. The Finance

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Bill has proposed to extend the date of investment to March 31, 2030. This amendment will take effect from April 1, 2025.

The foregoing amendment is a welcome extension, providing the stability and time frame necessary for global investors to take decisions and make substantial contributions to India's infrastructure, considering the long-term nature of investments in the infrastructure sector.

Presumptive taxation scheme for non-residents engaged in providing services for electronics manufacturing

The Finance Bill has proposed to introduce a presumptive tax regime at the rate of 25% for non-residents who are engaged in the business of providing services or technology to an Indian resident company engaged in electronic manufacturing. The presumptive tax rate of 25% will apply on the aggregate amount received or paid to the non-resident by the Indian resident company. This amendment will take effect from April 1, 2025.

Prior to the proposed amendment, a non-resident or a foreign company was liable to tax as business income on the profits from the foregoing activity at the applicable rates as there was no separate scheme for presumptive taxation for the said activity.

The motive of the amendment is to bring tax certainty to specified businesses. It reduces compliance costs and promotes ease of doing business. In our view, the foregoing change is a welcome initiative as it will position India as the global hub for electronics system design and manufacturing.

Harmonisation of significant economic presence and its applicability with business connection

Section 9 of the IT Act is a special deeming provision that provides specific circumstances under which a non-resident's income is deemed to accrue or arise in India. Section 9 contains the concept of "business connection" which stipulates that income earned by a non-resident through or from a business connection in India will be deemed to accrue or arise in India and will therefore be taxable in India.

Section 9 further provides what constitutes business connection and what is carved out from its meaning. One of the carve outs states that a non-resident shall not constitute business connection in India if the operations of the non-resident are limited to the purchase of goods in India for the purpose of exporting ("**Export Carve-out**")

The concept of Significant Economic Presence ("**SEP**") was brought in through the Finance Act, 2018 that *inter-alia*, includes within its ambit transaction in respect of any goods, services, or property carried out by a non-resident with any person in India, including the download of data or software in India, if the total payments from such transactions during the previous year exceed a prescribed amount. In case where a non-resident has SEP in India, such SEP shall constitute 'business connection' in India. Given that the scope of SEP is broad, it could inadvertently negate the Export Carve-out, creating a contradiction.

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To harmonize the provisions and maintain consistency, the Finance Bill has proposed an amendment to the definition of SEP. The amendment clarifies that the transactions or activities of a non-resident in India, which are confined to the purchase of goods in India for export, will not be considered as creating an SEP in India. This will align the provision with the existing Export Carve-out, ensuring that such transactions remain outside the scope of Indian taxation.

This amendment will take effect from April 1, 2025.

This is a welcome clarification as the Finance Bill has proposed to correct the anomaly. Going forward, transactions or activities of a non-resident in India that are confined to the purchase of goods in India for export purposes shall not constitute either a business connection or a significant economic presence of such non-resident in India.

Definition of "capital asset" amended for investment funds

Indian tax law defines the term "capital asset" to include property of any kind held by an assessee, whether or not connected with his business or profession, but does not include any stock-in-trade or personal assets. Further, securities held by a foreign institutional investor in accordance with the Securities and Exchange Board of India regulations are also treated as capital assets. However, there was uncertainty with respect to the treatment of investment funds as capital assets.

An "investment fund" means a fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or a Category II Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 or regulated under the International Financial Services Centres Authority (Fund Management) Regulations, 2022.

The Finance Bill has proposed that securities held by investment funds that are regulated by the Securities and Exchange Board of India Act, 1992 will be treated as capital assets and any income arising from the transfer of such securities will be considered capital gain. This amendment will take effect from April 1, 2025.

This is a helpful clarification. As a consequence of the amendment categorizing securities held by investment fund as a capital asset, the transfer of such securities shall be taxed as capital gains. Consequently, based on the FAQ issued by the Indian government on February 1, 2025 the income shall be a pass-through to be taxed in the hands of unit holder and not the investment fund.

Extension of timeline for tax benefits to Startups

Currently, Startups are allowed a deduction of 100% of the profits and gains derived by them for three (3) consecutive assessment years out of the ten (10) years beginning from

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the year of incorporation of the startup provided that the Startup is incorporated on or before the April 1, 2025. The Finance Bill has proposed to extend the date of incorporation of startups for qualifying for the foregoing deduction to April 1, 2030. This amendment will take effect from April 1, 2025.

This is a positive move as startups often take considerable time to identify angel investors or venture capital firms for their funding requirements.

Rationalisation of taxation of capital gains on transfer of capital assets by non-residents

The Finance (No, 2) Act, 2024 made substantial changes to the capital gains tax regime in India. The tax rate on long term capital gains arising from the transfer of equity shares made on or after July 23, 2024 was changed to 12.5% (plus applicable surcharge and cess), irrespective of whether the transferor is a resident or non-resident.

The tax rates for foreign portfolio investors are provided in section 115AD of the IT Act. While Finance (No, 2) Act, 2024 amended section 115AD of the IT Act to provide that long term capital gains arising on transfer of listed equity shares will be taxable at 12.5% (plus applicable surcharge and cess), long term capital gains arising on all other assets continued to be taxed at rate of 10%. This anomaly is proposed to be corrected by the Finance Bill. Going forward, any long-term capital gains arising to foreign portfolio investors will be subject to tax at 12.5% (plus applicable surcharge and cess).

The amendments will take effect from April 1, 2025.

Rationalization of provisions related to carry forward of losses in case of amalgamation

Section 72A of the IT Act provides for the carry-forward and set-off of accumulated losses and unabsorbed depreciation allowance, in case of amalgamation, demerger, business reorganisation, etc. Section 72A(1) of the IT Act provides that the accumulated losses and unabsorbed depreciation of the amalgamating company are to be deemed the loss or the unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected. Similar provisions have been provided for business reorganisations by which a company succeeds a firm or a proprietary concern or business reorganisations by which a limited liability partnership succeeds a private company or unlimited public company.

Typically, business losses cannot be carried forward for more than eight financial years from the financial year in which the loss was first computed. In case of amalgamations, the loss of predecessor entity gets a fresh life in the hands of the successor entity and therefore, provides the opportunity for the evergreening of losses of the predecessor entity. The Finance Bill proposes to end the foregoing issue by amending section 72A of the IT Act to limit the carry forward and set off of accumulated loss to eight (8) financial years from the immediately succeeding financial year for which such loss was first computed for the original predecessor entity. Note that the carry forward of losses in amalgamations is only

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allowed in cases like amalgamation of company owning an industrial undertaking or ship or hotel with another company. The amended provision will apply to amalgamation or business reorganisation effected on or after April 1, 2025.

The proposed amendment is likely to impact carry forward of losses in cases of conversion of firm/ proprietary concern into company or conversion of a private company/ unlisted public company into a limited liability partnership in a tax neutral manner. In cases where such conversions are not undertaken in a tax neutral manner (i.e., without fulfilling conditions under section 47 of the IT Act), carry forward of losses is not permitted under the IT Act. The proposed amendment is likely to have an impact on the amalgamation schemes pending approval from the court. Importantly, for mergers, the amended provision will apply from the effective date i.e., date of approval from court irrespective of the appointed date in the scheme. A clarification on this aspect will be helpful for the taxpayers.

TCS will not apply if taxes have already been withheld under a different section

Section 206C(1H) of the IT Act requires sellers to collect 0.1% tax on sales of goods exceeding INR5,000,000 (Indian Rupees Five Million), while section 194Q of the IT Act mandates buyers to deduct the same tax on payments to sellers for goods above INR5,000,000 (Indian Rupees Five Million). This creates confusion as both the tax collected at source ("**TCS**") by the seller and tax deducted at source ("**TDS**") by the buyer apply to the same transaction. To ease the compliance burden, the Finance Bill has proposed that with effect from April 1, 2025, TCS under section 206C(1H) will no longer apply if TDS has already been deducted under section 194Q of the IT Act.

This amendment brings in clarity to avoid dual taxation of the same income.

Obligation to furnish information re cryptocurrency assets

The Finance Act, 2022 introduced taxation of virtual digital assets ("**VDAs**") under section 115BBH of the IT Act, imposing a 30% tax on VDA transfers with no deductions except for the cost of acquisition. It also includes a 1% tax deduction on VDA transactions under section 194S of the IT Act. However, there were no reporting requirements prescribed for VDA under the IT Act. The Finance Bill proposes to introduce obligations on "reporting entities" to furnish information on transactions of crypto assets. A clarification will be provided by the Indian government with respect to the persons covered within reporting entities and the nature and manner of maintenance of information by the reporting entities.

The proposed amendment is geared towards intermediaries like cryptocurrency exchanges which are likely to be included within the ambit of "reporting entities." The rules will also clarify the intricacies of the due diligence to be carried out by the reporting entities for purpose of identification of any cryptocurrency-user or owner. This is likely to increase the compliance burden on the reporting entities and they will have to develop infrastructure to ensure that data is collected properly for reporting to the government. This amendment will take effect from April 1, 2025.

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Three-Year Block Approach for determining the arm's length price

Transfer pricing provisions under the IT Act require income arising from international transactions or specified domestic transactions ("**SDTs**") between associated enterprises to be computed on an arm's length price ("**ALP**") basis. The IT Act provides methods for determining the ALP in such transactions. The assessment proceedings of such taxpayers involve the Tax Assessing Officer ("**TAO**") referring the determination of the ALP be determined by the Transfer Pricing Officer ("**TPO**"). After the TPO determines the ALP, the TAO adjusts the taxpayer's total income in accordance with the TPO's order. Typically, entities engage in similar international transactions or SDTs on a yearly basis. Consequently, the process of referring these transactions to the TPO for ALP determination is repeated annually.

Given the complexity and administrative burden of this process, the Finance Bill has proposed to introduce section 92CA(3B), providing an option to taxpayers to apply the same ALP to "similar international transactions or SDTs" for a block of three (3) years. Under the amendment, the taxpayers must file a prescribed form within the specified timeframe to exercise the foregoing option. The TPO will assess the validity of the option and issue an appropriate order within one (1) month of its exercise, determining whether the transactions are similar and valid. Once confirmed, the ALP determined for an international transaction or SDT in the given year will be applied by the TAO to similar transactions or SDTs for the two (2) consecutive years immediately following that year.

This amendment marks a positive step in reducing compliance burdens and redundancy in transfer pricing proceedings by minimizing the need for multiple ALP determinations for the same or similar transactions across years.

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