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# A case for extending the ambit of **Presumptive Taxation**







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## Introduction

According to the Economic Survey Report 2017-18, the tax department loses over 65% of its cases against taxpayers upon appeal. This, coupled with the fact that the government is committed to making India an investor and taxpayer friendly country, leads to the inescapable conclusion that any method than can be adopted to make the tax system simpler, fairer and less litigative deserves serious consideration. The number of taxpayers on the register of the tax department can increase dramatically with the simplification of tax laws. A case in point is the increase in the number of taxpayers consequent to the introduction of presumptive basis of taxation for certain businesses and professions, on account of it being a simpler and equitable system.

The purpose of this paper is to discuss the need for further improvement in the scheme of presumptive taxation under the laws governing direct tax in India.

In the context of income tax, the term 'presumptive' is typically used in a situation where a certain proportion of receipts of the taxpayer is deemed to be his taxable income. Presumptive taxation can be used for any tax that is based on normal accounting record, such as income tax, value added tax or sales tax, turnover tax, GST, etc. but is most commonly used for income-tax. This paper focusses on direct taxation because a new indirect taxation regime in the country has already been introduced in the form of Goods & Service tax (GST) which, hopefully, will be the catalyst of reform of indirect taxation laws.

The objective of a presumptive taxation scheme is to encourage voluntary compliance by taxpayers engaged in small and medium level businesses. The administrative and compliance cost of the Income-tax department is also lower as compared to taxation of business under the regular provisions of law. The advocates for a

presumptive method of taxation also claim that it helps reduce tax avoidance. The use of presumptive taxation as a tax tool is gaining currency in a number of countries.

India has introduced presumptive taxation for certain types of businesses and professions. The government, over the years, has liberalized the relevant provisions to cover a greater number of taxpayers. The Finance Minister in his budget speech for 2018-19 recognized that there has been a 41% increase under the presumptive scheme, which is a clear indication that the taxpayer prefers to opt for presumptive taxation over the normal approach. The relevant extract of budget speech of 2018-19 is provided below:

*"Madam Speaker, recognising the need for facilitating compliance, Government had liberalized the presumptive income scheme for small traders and entrepreneurs with annual turnover of less than ₹2 crores and introduced a similar scheme for professionals with annual turnover of less than ₹50 lakhs with the hope that there would be significant increase in compliance. Under this scheme, 41% more returns were filed during this year which shows that many more persons are joining the tax net under simplified scheme."*

The finance minister in his budget speech also acknowledged the fact that the turnover and taxes paid by the taxpayer under the scheme were not satisfactory. Thus, there is a need to introduce anti abuse provisions or certain conditions, in order to ensure that the scheme is not misused and at the same time government meets their revenue target with lesser administration. Critics of the presumptive scheme of taxation argue that it could result in a complete re-writing of the law and might unsettle existing tax positions which have crystallized over a period of time. However, this paper provides for a solution that can be considered for the scheme to be extended to a larger group of taxpayers and at the

same time potentially increase revenue by taking away numerous incentives and holidays provided under the Income-tax Act, 1961 ("IT Act").

It is pertinent to point out at this point that withholding taxes are sometimes clubbed together with presumptive taxes. Withholding taxes can also achieve the effect of taxation based on an alternative simplified base. Withholding is commonly used for income tax and is usually based on the gross amount of a payment. The legal nature of withholding taxes is normally not the same as that of presumptive taxes, because the taxpayer normally has the right to file a return and receive a refund of excess amounts withheld. Therefore, although there is a strain of commonality between withholding and presumptive techniques, the former has not been considered for the purpose of this paper.

It may also be noted that presumptive taxation is not comparable to minimum alternative tax (MAT) which is levied on the book profits of a company. MAT is a mechanism of collecting tax by the tax authorities from companies who are earning profits and not paying tax and in some cases distributing the profits by way of dividend. MAT, being an alternative way of collecting tax is different from presumptive taxation scheme and hence not discussed in this paper.

### Current Scheme Under the IT Act

The IT Act has framed the scheme of presumptive taxation to give relief to small taxpayers from the tedious job of maintenance of books of account and from getting the accounts audited. The scheme was introduced in 1993 and has subsequently been amended from time to time. Budget 2016 introduced certain amendments to the scheme by extending its application to professionals. There are also separate schemes applicable to non-residents receiving income from certain sources.

The various schemes of presumptive taxation currently available under the IT Act are discussed below:

**Section 44AD** – Special provisions for computing profits and gains of business on presumptive basis

Eligible Taxpayer: Resident Individual, HUF and partnership firm not claiming any tax holidays

Eligible Business: Scheme applicable to any business, except the following businesses:

- business of plying, hiring or leasing goods carriages referred in section 44AE.
- a person who is carrying on any agency business.
- a person who is earning income in the nature of commission or brokerage
- any business whose total turnover or gross receipts exceeds two crore rupees.

Taxable income: Income is computed at 8% of the turnover or gross receipts of the eligible business for the year. Further, income is calculated at rate of 6% in respect of total turnover or gross receipts which is received by an account payee cheque or draft or use of electronic clearing system.

In case profits claimed by the taxpayer is lower than the deemed profits of 8%/6% then the taxpayer is required to maintain detailed books of accounts and get the same audited.

The Finance Act 2016 amended the provision and provided for the following:

- Salary and interest paid to the partners by the firm shall not be allowed to be deducted from the income determined under section 44AD.
- If the taxpayer opts for the scheme of presumptive taxation then the taxpayer is required to follow the same scheme for next five years. If case of failure to do so, the scheme shall not be available to the taxpayer for next five years.

**Section 44ADA** – Special provisions for computing profits and gains of profession on presumptive basis



Earlier, there was no scheme of presumptive taxation for a taxpayer engaged in a profession. The Finance Act 2016 introduced a scheme for presumptive taxation for taxpayer engaged in specified professions, effective from the financial year 2016-17. The same is discussed below:

**Eligible Taxpayer:** Person resident in India, carrying on a specified profession whose gross receipts do not exceed fifty lakh rupees in a financial year. Specified profession means legal, medical, engineering or architectural, accountancy, technical consultancy, interior decoration and any other profession as notified by CBDT.

**Taxable income:** Income will be computed at 50% of the gross receipts from the profession for the financial year.

In case profits claimed by the taxpayer is lower than the deemed profits of 50% then the taxpayer is required to maintain detailed books of accounts and get the same audited.

**Section 44AE** – Special provisions for computing profits and gains of business of plying, hiring or leasing of goods carriage

**Eligible Taxpayer:** Applicable to all taxpayers who own not more than ten goods carriages at any time during the previous year and who is engaged in the business of plying, hiring or leasing such goods carriages.

**Taxable income:** Income will be computed on an estimated basis of INR. 7,500 per month or part thereof during which the goods vehicle is owned by the taxpayer, in the previous year.

**Section 44B:** Special provision for shipping business for NRIs

**Eligible Taxpayer:** Non-resident engaged in shipping business.

**Taxable income:** A sum equal to 7.5% of the aggregate of the specified amounts shall be deemed to be the profits and gains of such business. Specified amount for this purpose means:

- The amount paid or payable (whether in or out of India) to the taxpayer or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and
- The amount received or deemed to be received in India by or on behalf of the taxpayer on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

Under this scheme, the taxpayer does not have option to show profits lower than 7.5% of the specified amount.

**Section 44BBA:** Special provision for business of operation of aircraft for NRIs

**Eligible Taxpayer:** Non-resident engaged in the business of operation of aircraft.

**Taxable income:** A sum equal to 5% of the aggregate of the specified amounts shall be deemed to be the profits and gains of such business. Specified amount for this purpose means:

- The amount paid or payable (whether in or out of India) to the taxpayer or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and
- The amount received or deemed to be received in India by or on behalf of the taxpayer on account of the carriage of passengers, livestock, mail or goods from any place outside India.

Under this scheme as well, the taxpayer does not have option to declare profits lower than 10% of the specified amount.

**Section 44BB:** Special provision for business of exploration of mineral oils for NRIs

**Eligible Taxpayer:** Non-resident engaged in the business of exploration of mineral oils, etc.

**Taxable income:** A sum equal to 10% of the aggregate of the specified amounts shall be deemed to be the profits and gains of such business. Specified amount for this purpose means:

- The amount paid or payable (whether in or out of India) to the taxpayer or to any person on his behalf on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils in India; and
- The amount received or deemed to be received in India by or on behalf of the taxpayer on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils outside India.

Under this scheme, the taxpayer has the option to show lower than the deemed profits of 10%, however, the taxpayer would be required to maintain detailed books of accounts and get the same audited.

**Section 44BBB:** Special provision for business of civil construction etc. for foreign company

**Eligible Taxpayer:** Non-resident engaged in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof, in certain turnkey power projects.

**Taxable income:** A sum equal to 10% of the amounts paid or payable, (whether in or out of India) to the said taxpayer or to any person on his behalf, shall be deemed to be the profits and gains of such business.

Under this scheme, the taxpayer has the option to show lower than the deemed profits of 10%, however, the taxpayer is required to maintain detailed books of accounts and get the same audited.

The aforementioned paragraphs clearly indicate that various presumptive taxation have been introduced in India for some

time now, the schemes themselves have been applicable to only a small subset of taxpayers. Little wonder that the schemes have not given desired results in terms of revenue.

### **Proposed Solution- A Comprehensive Scheme for Presumptive Taxation**

An overarching presumptive scheme of taxation should target three groups of taxpayers, namely, small businesses and professionals, individuals and corporates, without making any distinction based on the nature of business or profession.

The salient features of the proposed scheme of presumptive taxation could be as follows:

- The scheme may be available to a taxpayer at his option for income under the head salary and profits & gains from business and profession.
- The option, to be governed by the provisions of the scheme, could be exercised by the taxpayer in each assessment year and would be independent of the option exercised by the taxpayer in any other assessment year.
- Expenses / allowances incurred in the assessment year where the taxpayer has opted to be governed by the scheme will be presumed to be allowed in respect of that assessment year for all purposes of the IT Act.
- Set off of current as well as brought forward losses (including unabsorbed depreciation) of earlier years will be allowable even against the profits arrived at as per the scheme.
- Once the taxpayer opts for the scheme, no deduction or exemption under any of the tax breaks/holidays available under the IT Act should be allowed.
- While the requirement of filing of a return would apply even to such taxpayers, given the ease in computation of income under the scheme, a tax payer should be in a position to file the return on his own.
- In the event a taxpayer has filed his return of income under the scheme, there should be no scrutiny of his income under section 143(2) of the IT Act and the provisions of section 147 of the IT Act may be attracted only if the income escaping assessment exceeds INR 5 lakhs.



- An option should be given to the taxpayer to declare lower profits / income as compared to profits to be declared under the scheme of presumptive taxation, provided the taxpayer maintains detail books of accounts and gets the same audited.
- The rate of tax applicable under the scheme can be decided by the government based on its estimates of what the current effective rate of tax is for a certain class of tax payers and its own estimates as to (a) how much revenue such a scheme would mop up annually (b) the cost savings that would result on account of a reduced administrative burden and reduced litigation (including the interest cost of paying refunds to a vast number of taxpayers).

The scheme for presumptive income under the various heads of income is discussed below:

### Salary Income

- Currently, there is no deduction allowed for any expenses incurred by the employee for his employment. Finance Bill 2017 has proposed to allow a standard deduction upto Rs 40,000/- from salary income. However, the medical reimbursement of Rs 15,000/- and transport allowance of Rs. 19,200/- which were considered to be tax exempt has been done away with. Salaried employees are major contributors to the income-tax collected by the tax authorities. However, as a class of taxpayers, it is the salaried employees who face hardship and suffer the most, since there is little or no scope for claiming any expenditure against their salary income.
- Hence, to provide a relief to salaried taxpayers, the following scheme is being proposed:
  - The taxpayer would be given an option to compute his income chargeable to tax under the head ‘Salaries’ on a presumptive basis at x% of the aggregate of the total cost to the employer.
  - The term ‘cost to employer’ may be defined to mean the total cost (including depreciation) incurred by the employer with respect to the taxpayer towards his salary /expenses ,perquisites and contributions to any fund

for the benefit of the taxpayer (excluding gratuity fund contributions).

- The taxpayer should be given an option to declare a lower profit, provided, the taxpayer maintains prescribed books of account and such books are audited under any law or specifically for the purpose of this provision. Where the books are audited specifically for the purpose of this provision, a form of audit report should be prescribed. Taxpayers opting for the scheme will furnish along with their return of Income, a computation of income from business/profession under the scheme in the prescribed form.

### Income from business / profession

- Currently, the presumptive basis of taxation is available for small business class with a turnover of up to 2 crores and for professionals having gross receipt up to Rs 50 lakhs. Hence, the subject taxpayers exceeding the aforesaid limit are required to maintain detailed books of accounts to determine the profits/gains and get the same audited on a yearly basis.
- It is suggested that in case of taxpayers carrying on a business:
  - All types of taxpayers should be covered whether individual, HUF, Firm, LLP or company, irrespective of the type of business carried out by the taxpayer.
  - The threshold limit for turnover from the business should be a minimum of INR 50 crores.
  - The profit percentage should be kept at 8% of the total turnover and in case of a transaction concluded via digital mechanism the profits should be 6% of the total turnover.
  - In case of a firm or LLP, deduction in respect of salary to the partners should be allowed as deductible expenditure. The salary should be separately taxable in the hands of the partners.

### Income from profession:

- All types of taxpayers should be covered irrespective of the type of profession carried out .



- The threshold limit for gross receipt should be increased to INR 10 crores.
- The profit percentage should be reduced to one-third (i.e. 33.33%) of the gross receipt.
- In case of a firm or LLP, deduction in respect of salary to the partners should be allowed as a deductible expenditure. The salary should be separately taxable in the hands of the partners.

The tax authorities may face some hardships to determine whether a taxpayer has disclosed the turnover or gross receipt appropriately, hence, tax authorities would need to put in place a proper mechanism to examine the same. One way to determine the same is to cross check with the return filed under the other laws, for example the GST return and also ask the taxpayer to submit his bank statements for the financial year in question.

### Conclusion & Way Forward

Presumptive taxation is one way, though not the only way, by which the process of fiscal reform currently under way in the country may be further advanced. Another element to take into account in evaluating whether and how presumptive approaches should be used is that presumptions can involve the granting of a tax preference. Depending on how a presumption is determined and applied, it can result in a reduced burden for certain kinds of taxpayers. This is particularly the case where the presumption is elective, as in the case of the French contractual method. Thus, the purpose of the presumption can become the protection of a certain group of taxpayers (e.g., small business) rather than protection of revenue. In cases where the presumption is preferential, its application is often limited. For example, it may be available

only for taxpayers with a turnover below a certain amount. While this approach has some justification, it has the disadvantage of discouraging incorporation in situations where the presumptive method is advantageous to the taxpayer.

Some countries make little use of presumptive methods of taxation, given that they inherently involve unfairness on account of being a departure from the normal accounting methods used to determine the tax base. Taxpayers who genuinely have no income might end up having to pay tax under a presumptive method, however, this can be addressed by giving the option to the taxpayer to get the accounts audited and offer lower income for tax.

If the scope of the scheme is extended, a large set of the income earners may voluntarily opt for it, since fear of the taxman and lethargy in complying with the provisions of law will be reduced. Deterrent measures, such as penal interest, penalties and prosecutions, often have only a limited impact since they can be effective only if detection mechanisms are robust and implementation is unbiased. A presumptive scheme would in fact encourage greater compliance at all levels, thereby redirecting the policing efforts of the department. It will also lower litigation costs and reduce interest outflow for the government on account of refunds having to be issued in a vast majority of cases. The manner in which the scheme is devised will effectively reduce the interaction with the tax department and will create no ambiguity when it comes to determining the total income of the taxpayer opting for the scheme. The simplicity of the scheme would enable the taxman to instead focus his efforts in detecting cases of errant taxpayers who are outside the tax net altogether.



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