
Finance Act, 2023: Taxing dilemma on distributed incomes by business trusts



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The Finance Bill, 2023 (introduced on 1 Feb 2023) received presidential assent and accordingly Finance Act, 2023 is applicable from financial year 2023-24. The bill was introduced in the Lok Sabha on 24 March 2023, wherein new amendments were made, and some proposed amendments were modified. One such important amendment is in relation to taxation of income in the hands of unit holders of business trusts (i.e. Infrastructure Investment Trusts and Real Estate Investment Trusts).

The Finance Bill, 2023 (introduced on 1 Feb 2023) had proposed to insert clause (xii) to section [56\(2\)](#) of the Income Tax Act, 1961 ('Act') to provide that any sum received by a unit holder from a business trust is considered income of the unitholder, except if the sum received is in the nature of interest or dividend from SPV, or rental income from a REIT, or if it is taxable in the hands of the business trust under section [115UA](#).

The Finance Act, 2023, revamped the proposed section and substituted the same with a new provision contained in clause (xii) of section 56(2) and also inserted explanations 1 and 2 to clause (ii) of section [48](#).

This article attempts to understand the aforesaid amendments including the interpretational issues that can come up on practical application.

Rationale for introduction of new provisions?

- Unit holders of business trusts are entitled to receive distributions from the business trusts on account of income earned by such Trusts. Certain incomes earned by the business trusts are accorded a pass-through status and accordingly taxable at the unit holders' level.
- It is an industry wide practice to categorize some of the distributions to the unit holders as repayment of debt.
- Prior to amendment, there was no express provision under the Act to tax such distribution and accordingly, a view was taken that the amount categorized as repayment of debt was not taxable either at business trust level or at the unit holders' level.
- In order to overcome this, various amendments are made in the Act to tax the distributions made by the business trusts in the hands of the unit holders.

Distributions by business trusts – Whether past distributions taxable?

- As per the amendment, distributions by the business trusts (other than specified exclusions) are taxable as income from other sources in the hands of the unit holders.
- The provisions of section 56(2)(xii) apply to any specified sum received **during the previous year**. However, the formula for calculating the specified sum categorically mentions 'aggregate of sum distributed by the business trust with respect to the units during the previous year **or any earlier previous years...**'
- Accordingly, one may ponder if the intention of the law is to cover only prospective distributions or all such distributions (not chargeable to tax) made in any earlier previous year, i.e. a retrospective impact.
- Let us try to understand the same with an example.

Particulars	FY 21-22	FY 22-23	FY 23-24	Prospective impact	Retrospective impact
Number of units	100				
Amount invested per unit	1,000				
Total amount invested	1,00,000				
Amount distributed as repayment of debt	15,000	15,000	20,000		
Amount distributed within the meaning of section 56(2)(xii)				20,000	50,000 (15+15+20)

- As seen above, in case where it is considered that the provisions may have a retrospective impact, all distributions made in earlier years come under the purview of tax net.
- It is worth noting that the memorandum to Finance Bill, 2023 specifically mentions that distributions characterized as repayment of debt, do not suffer taxation either at the business trust level or at unit holders' level. Hence, where the legislature accepts that there did not exist a specific provision for taxing a particular income, is it justified in introducing a provision that covers past distributions?

Cost of units in the hands of unit holder – A conundrum to solve

- Explanation 1 to section 48 provides that the cost of acquisition of a unit of a business trust shall be reduced and shall be deemed to have always been reduced by any sum received by a unit holder from the business trust with respect to such unit, if it is not chargeable as income from other sources, i.e. provision discussed above.
- In the amendment, the words used are deemed to have always been received and hence it becomes pertinent to evaluate whether is the intention to cover only the prospective distribution or whether even retrospective distributions shall be covered for the purpose of determining cost of the unit.

- Further, discussion is also warranted on the meaning of amount not chargeable to tax under income from other sources for the purpose of calculation of cost of unit u/s 48. Since a deduction is allowed for the cost while calculating income from other sources, does it mean that the gross amount (without deducting cost) or net amount is to be considered?
- Let us try to understand the amendment with an example-

Example:

Amount taxable under section 56(2)(xii) – Income from other sources

Particulars	Amount
A = Sum distributed	1,35,000
B= Amount at which such unit was issued by the business trust	1,00,000
C= Amount already taxed in any of the previous year	Nil
A-B-C	35,000
Amount taxable under section 56(2)(xii)	35,000

Determination of cost of units - Assuming all the units are redeemed by the unit holder at INR 1,50,000

Scenario A: INR 1,35,000 is considered as chargeable to tax under IFOS

Particulars	Amount
Sales Consideration	1,50,000
Cost of Acquisition	
Purchase price	1,00,000
Less: Amount not chargeable to tax	Nil
	1,00,000
Capital Gains	50,000

Scenario B: INR 35,000 is considered as chargeable to tax under IFOS

Particulars	Amount
Sales Consideration	1,50,000
Cost of Acquisition	
Purchase price	1,00,000
Less: Amount not chargeable to tax	1,00,000
	Nil
Capital Gains	1,50,000

On analyzing the above example, there are certain points to ponder:

- ◆ The question that arises is what is the amount chargeable to tax under IFOS, gross amount of INR 1,35,000 or net amount of INR 35,000?
- ◆ If the amount of INR 1,35,000 is considered to be chargeable to tax, it shall result in double deduction of the amount invested in the units (INR 1,00,000) – one u/s 56(2)(xii) and another u/s 48? Hence, it may be difficult to advance this position.
- ◆ The intention of legislature may not be to provide double deduction and hence one may need to evaluate the implications while calculating the cost of units.

Having said this, businesses will now have to spend considerable time to identify the gamut of taxation issues due to the amendment in the provisions. It will now be a wait and watch situation to understand whether tax authorities will provide clarifications on above.

