CBDT issues press release to reduce deemed profit rate for eligible business under Section 44AD of the Income-tax Act who will accept payments through digital mode

Background
The government has taken various steps to combat the scourge of corruption and black money in the last two and half years. In the past few months, the Union Cabinet has approved various initiatives to encourage digital payments and a transition to a cash-less economy in a strategic manner.

The government had also launched a major drive for financial inclusion in terms of opening ‘Jan Dhan’ accounts, giving a statutory basis for ‘Aadhar’, implementation of direct benefit transfer, the introduction of ‘RuPay’ cards and Income Declaration Scheme 2016 for unaccounted money. Demonetisation of INR500 and 1000 notes is also another important milestone in this endeavour.

Following demonetisation, there has been a spurt in digital payments across the country and both the volume and amount of money transacted through digital methods have increased since November 2016. The government is also encouraging small businesses by giving benefits under the Income-tax Act, 1961 (the Act), so that more transaction will be carried through banking channel/digital mode.

CBDT press release

Section 44AD of the Act provides that the taxpayer engaged in any eligible business and having a turnover of INR 2 crore or less, the profit is deemed to be 8 per cent of the total turnover or gross receipts.

The Central Board of Direct Taxes (CBDT) has issued a press release stating that in order to achieve the government’s mission of moving towards cashless economy and to incentivise small traders/businesses to proactively accept payments by digital means, it has been decided to reduce the existing rate of deemed profit of 8 per cent under Section 44AD of the Act to 6 per cent in respect of the amount of total turnover or gross receipts received through banking channel/digital means for the Financial Year (FY) 2016-17.

However, the existing rate of deemed profit of 8 per cent referred to in Section 44AD of the Act, shall continue to apply in respect of total turnover or gross receipts received in cash. Legislative amendment in this regard shall be carried out through the Finance Bill, 2017.

Our comments
To increase overall transparency in the economy and to remove the pernicious influence of cash on the political and economic system, the government introduced measures that would influence the behaviour of the consumers as well as merchants to adopt digital payment instruments. It is now possible by leveraging technology to carry out business transactions digitally through mechanisms such as UPI, USSD, RuPay cards, etc. The primary aim of these measures is to incentivise digital transactions so that electronic payments are adopted by eligible business who are dealing mainly in cash.

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1 CBDT press release, dated 19 December 2016
2 Eligible business means –
   (i) any business except the business of plying, hiring or leasing goods carriages referred to in Section 44AE; and
   (ii) whose total turnover or gross receipts in the previous year does not exceed an amount of two crore rupees.
This press release indicates that the government is more vigilant in reducing black money and approaching merchants/small traders to shift to digital payment instruments. The government’s decision of reducing the existing rate of deemed profit rate in respect of amount received through banking channels/digital mode is a welcome move. However, the taxpayer may need clarity on this provision (i.e. Section 44AD of the Act) where the transaction is partly made in cash and partly through banking channel/digital mode. Further, taxpayers who were having high cash transactions and recording their transactions through digital payment for the first time may face challenges from the income tax department due to a sudden increase in their revenue in comparison to last year.
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