Income-tax Bill, 2025: Capital Gains & Corporate Re-organisation — *Old Wine in a New Bottle with some Fizz*

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Overview

The Proposed Bill largely aligns with the ITA provisions in terms of the overall framework of capital gains tax, tax neutrality of re-organisations as well as set-off and carry forward of losses. The continuity of use of key concepts and phraseology used under the ITA should mitigate the risk of any undesired litigation on settled issues.

Some interesting changes are, applicability of AMT to all LLPs/firms, denial of inter-corporate dividend deduction to domestic companies claiming concessional headline tax rate of 22%, reintroduction of forex fluctuation benefit to non-residents on unlisted share sale, section 79 related amendments for denying carry forward and set-off in case of 49% or more change in beneficial owner of shares, few lapses in incorporating recent Finance Bill, 2025 proposals, etc.

Some of these changes seem to be erroneous/drafting errors, while the others may have a substantive intent behind them. It will be of great help if the tax department issues clarifications to address these issues so that taxpayers have adequate time to understand the corresponding implications on their structures.

Introduction

The Income-tax Act, 1961 (**"ITA"**), has been the cornerstone of India's direct taxation system for over six decades. Over time, it has undergone numerous amendments based on economic policies, political considerations and at times, ineptness of the thinkers behind it. The Income-tax Bill, 2025 (**"Proposed Bill"**), tabled by the Finance Minister, Smt. Nirmala Sitharaman in the Parliament on 13 February 2025, is aimed at simplifying and modernizing India's tax structure. However, a closer look at the Proposed Bill raises the question: Is it truly a substantive reform, or just a rearrangement of the old tax law with minor tweaks?

This article attempts to cover provisions relating to capital gains, business reorganization and set off & carry forward of losses.

1. Capital Gains

1.1. The Proposed Bill largely reflects the established framework under the ITA and assures continuity in terms of: (i) what constitutes capital asset; (ii) trigger of capital gains provisions for

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various scenarios (transfer, liquidation etc); and (iii) tax rates (12.5%/20%/ordinary income tax rate). The holding period in case of transfer of capital assets also remains in line with the extant law. It maintains a uniform holding period of 24 months for most assets to qualify as long-term capital gains (**"LTCG"**). Exceptions to this include listed equity shares, units of equity-oriented mutual funds, zero coupon bonds and units of Unit Trust of India, which retain a 12-month holding period for LTCG treatment, and transfer of business undertaking by way of slump sale, where the required holding period for LTCG treatment remains 36 months.

1.2. Another key provision that remains unchanged is the grandfathering of cost of listed equity shares based on their fair market value as on January 31, 2018, which was introduced to protect investors from retrospective taxation following the reintroduction of LTCG tax for on-market sale of listed equity shares. While these aspects provide stability, certain key changes, as discussed below, require closer examination to assess their broader impact. The deeming fiction for considering fair market value as the sale consideration in case of sale of land/building/unquoted shares remains consistent too.

1.3. ***Section 112 of the ITA vis-à-vis Section 197 of the Proposed Bill | A Shift in Approach***

1.3.1. Section 112 of the ITA governs the taxation of long-term capital gains on assets other than listed equity shares, equity-oriented mutual funds and units of business trust (which are covered under Section 112A, subject to fulfilment of stipulated conditions). Further, in case of transfer of assets, being unlisted shares and securities, by non-residents, tax is computed at 12.5% (excluding surcharge and cess) without giving effect to the first and second provisos to Section 48 of the ITA.

1.3.2. The first proviso to Section 48 of the ITA, introduced vide the Finance Act, 1989, allowed non-resident investors to compute capital gains in the same foreign currency which was used for undertaking the original investment. This was introduced to offset any adverse impact of Indian rupee depreciation, which could otherwise inflate taxable gains for foreign investors, without any corresponding real gain in foreign currency terms.

1.3.3. The Finance Act, 2012 amended Section 112(1)(c)(iii) of the ITA whereby it halved the LTCG tax rate for non-residents on the sale of unlisted shares from 20% to 10%, while also removing foreign exchange fluctuation benefits. This move ensured parity among non-resident investors, other than Foreign Portfolio Investors (**"FPIs"**), by providing a uniform tax rate on unlisted shares and securities and eliminating distortions caused by fluctuating exchange rates.

1.3.4. The Proposed Bill now appears to reverse this approach. A reading of Section 197 of the Proposed Bill reveals no separate exclusion referencing Section 72 (which corresponds to the existing Section 48 of the ITA). As a result, LTCG

on the sale of unlisted shares by non-residents (other than FPIs) could be taxed at 12.5%, albeit with the benefit of foreign exchange fluctuation adjustments.

1.3.5. This comes at a time when the Indian rupee has depreciated significantly against major global currencies. Between 2011 and 2025 alone, the exchange rate has nearly doubled from ₹ 45/USD to ₹ 87/USD, indicating an almost 95% depreciation. This means that USD 1 invested in 2011 will remain so in 2025 even if the underlying INR value of the investment has almost doubled. By allowing this adjustment, the government appears to be reverting to the pre-2012 computation framework, which could reduce the effective tax burden for non-residents by aligning it with their home currency gain/loss situation.

1.4. ***Indirect Transfer | Potential increase in coverage of transactions***

Presently, the ITA taxes transfer of shares in a foreign company or interest in a foreign entity, which in either case derives substantial value from Indian assets. The Finance Act, 2012, by introducing Explanation 5 to Section 9(1)(i), retrospectively overturned the Vodafone ruling by making indirect transfer of shares taxable in India if they derive significant value from Indian assets.

The Proposed Bill [Section 9(2)(d) read with Section 9(9)] attempts to refine the language of the present Explanation 5 to Section 9(1)(i) by introducing a slightly different phrasing of the provision – see below extract of the proposed Section 9(9):

"An asset or a capital asset, being any share of, or interest in, a company or entity registered or incorporated outside India, which derives substantial value from assets located in India."

In doing so, in addition to taxing transfer of (a) shares in a company registered/incorporated outside India; and (b) interest in an entity registered/incorporated outside India, it potentially seeks to also cover gains on transfer of (c) shares in an entity registered/incorporated outside India; and (d) interest in a company registered/incorporated outside India.

1.5. ***Liquidation Taxation | Expanding Coverage***

1.5.1. Explanation 1 to the definition of short-term capital asset under Section 2(42A) of the ITA, inter alia, provides that for determining whether capital gains on transfer of shares of a company in liquidation are short-term or long-term, the period subsequent to the company going into liquidation shall be excluded.

1.5.2. The Proposed Bill rewords the scope of covered assets to provide that the period of holding subsequent to the date on which the company goes into liquidation is to be excluded for all other instruments held in such company (and not limited to shares). This means that if an investor holds other forms of securities, such as debentures, in a liquidating company, their period of holding will also be frozen from the date of the company going into liquidation.

1.6. ***Transition Provisions in case of Withdrawal of Exemption |Eliminating***

Retroactive Taxation on Exempt Transfers

1.6.1. Section 47A of the ITA deals with taxability in case of violation of conditions based on which certain transfers were not regarded as such for capital gains tax purposes under Section 47 (such as transfer of a capital asset from holding company to wholly owned subsidiary and vice versa). If these conditions are breached, the previously exempted transfer is retrospectively deemed taxable in the year it originally occurred, and capital gains tax is imposed accordingly, along with applicable interest. Notably, the corresponding provision under the Proposed Bill [Section 71] is also worded on similar lines.

1.6.2. However, the transition provision under Section 536(q) of the Proposed Bill (dealing with Repeals and Savings) modifies this approach. It states that if the conditions under Section 47A of the ITA are met (leading to violation), the tax shall be levied in the year in which such conditions are breached, rather than retrospectively in the original year of transfer.

1.7. ***Amendments proposed in the Finance Bill, 2025 | Some obvious errors in the Proposed Bill which are likely to be corrected***

Taxation of REIT and InVIT

1.7.1. The Finance (No. 2) Act, 2014, introduced a special taxation regime for Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InVITs) under Section 115UA of the ITA. It grants pass-through taxation for specified income streams, such as interest, dividends, and rental income, which are taxed in the hands of unit holders unless exempted. Other incomes are taxed at the maximum marginal rate, except for capital gains, which are subject to preferential rates under Sections 111A and 112.

1.7.2. The Finance Bill, 2025 proposes an amendment to include Section 112A (covering long-term capital gains on listed equity shares and equity-oriented mutual funds) within Section 115UA to ensure uniform capital gains taxation. However, the Proposed Bill omits a reference to Section 198, which corresponds to the current Section 112A, likely due to a drafting oversight that may be corrected before enactment.

Tax Neutral Relocation of Offshore Funds

1.7.3. To promote the development of International Financial Services Centres (**"IFSCs"**), the ITA provides for a tax-neutral relocation of offshore funds, provided the resulting fund is registered as a Category I, II, or III Alternate Investment Fund (AIF). The Finance Bill, 2025, proposes to expand this tax exemption to include offshore funds relocating to retail schemes or Exchange Traded Funds (**"ETFs"**) under the IFSC Authority (Fund Management) Regulations, 2022. Additionally, it extended the sunset date for such relocations from 31 March 2025 to 31 March 2030, allowing more time for fund managers to shift operations to IFSCs.

1.7.4. Despite these amendments proposed in the Finance Bill, 2025, the Proposed Bill incorrectly retains the original sunset date of 31 March 2025 instead of reflecting the extended deadline of 31 March 2030.

2. Re-organisation Provisions

In general, the provisions relating to tax neutrality of amalgamation, demerger, company to LLP conversions, etc. have largely been left untouched. However, few notable issues having an indirect impact on ownership structures are discussed below:

2.1. *Dividend Setback | Proposed Bill Ends Inter-Corporate Dividend Deduction for 22% CTR companies*

2.1.1. The concessional tax regime (**"CTR"**) introduced under section 115BAA of the ITA was aimed at simplifying corporate taxation by offering reduced tax rates to domestic companies in exchange for foregoing various deductions and exemptions. Under the existing framework, companies opting for the 22% CTR or the 15% CTR (under Section 115BAB, applicable to new manufacturing companies) are generally not permitted to claim certain special/ additional deductions. However, two key exceptions were provided: (i) deductions for employment cost of new employees under Section 80JJAA of the ITA and (ii) deduction of inter-corporate dividends under Section 80M of the ITA. These deductions ensured encouragement to job creation and avoidance of cascading taxation on dividend income in corporate holding structure respectively.

2.1.2. The Proposed Bill retains the deduction for employment costs in both the 15% and 22% concessional tax regimes. However, a notable change is the restriction of inter-corporate dividend deduction to companies which opt/have already opted for the 22% CTR, whereby such companies would be subject to full taxation on dividends received from domestic or foreign companies, irrespective of whether they upstream dividend within the prescribed timelines.

2.1.3. Such removal of the inter-corporate dividend deduction for companies under the 22% CTR could result in a higher effective tax burden for multi-tiered corporate structures.

2.1.4. If this proposal gets enacted in the same form, it will mark a significant policy shift, potentially impacting several large and small business with corporate holding structures. Such structure may need to be reviewed and altered to address this additional cost

2.2. *Section 79 of the ITA vis-à-vis Section 119 of the Proposed Bill | A Step Forward or Backward?*

As per Section 79 of the ITA, losses of a closely held company are allowed to be carried forward and set off only if the at least 51% of the voting power is beneficially held by persons who beneficially held the shares on the last day of the year in which losses were incurred.

The Proposed Bill carries three key changes in the corresponding Section 119 from the existing ITA.

2.2.1. Firstly, there is an amendment in the language from 'persons who

beneficially held shares of the company' to 'beneficial owner of shares of the company'.

A question that has often come up before the Indian judiciary is whether beneficial ownership can be said to have remained unchanged if the registered owner of shares, holding more than 49% of the voting power, has changed. Courts and Tribunal have taken contrary positions on this issue. The Karnataka High Court, in ***CIT vs. AMCO Power Systems Limited [[2015] 62 taxmann.com 350 (Karnataka)]***, held that a holding company inherently controls its wholly-owned subsidiary and, by extension, exercises voting power over its step-down subsidiary. However, the Delhi High Court, in ***Yum Restaurants (India) Private Limited vs. ITO [S-755-ITAT-2014 (DEL)]***, ruled that an unchanged ultimate holding company does not automatically imply unchanged beneficial ownership, placing the onus on the taxpayer to prove the existence of a separate beneficial shareholder entitled to voting rights, dividends, etc. Similarly, in ***ACIT vs. WSP Consultants India Private Limited [[2022] 140 taxmann.com 65 (Delhi - Trib.)]***, the Delhi Tribunal held that in the absence of evidence proving that the ultimate holding company was the beneficial owner, the registered shareholder would be presumed to hold beneficial ownership.

It will be interesting to see how the judiciary interprets the provisions of this section based on this change in language. One interpretation taken by the Mumbai Tribunal in the case of ***Tainwala Trading and Investments Co. Limited vs. ACIT [[2012] 22 taxmann.com 68 (Mum.)]*** (in the context of section 79) is that a person is said to be a beneficial owner of shares when they are held by someone else on his behalf, meaning thereby that the registered owner is different from the actual or the beneficial owner. This is aligned with its view of the Delhi Bench of the Tribunal in WSP Consultants India Private Limited (supra).

Notably, the term 'beneficial owner' finds place in the ITA under the following sections (i) 2(22)(e); (ii) 2(32); (iii) 10(23FB); (iv) 40A, (v) 45(2A), (vi) 94A, (vii) 102 and (viii) 139 . Guidance can be drawn from the past interpretation under these provisions for as well.

2.2.2. Second amendment pertains to the conditions under which losses can be carried forward and set off against future income. Under the existing framework, this benefit of carry forward and set-off is available if at least 51% of the voting power is beneficially held by the same shareholders who held the shares on the last day of the year in which the loss was incurred. There was ambiguity regarding whether the right to carry forward and set off losses would be restored if the shareholding was subsequently restructured to meet the 51% threshold in any future year of setting off such loss. The Mumbai bench of the Tribunal, in ***Sodexo India Services Private Limited vs. PCIT [TS-79-ITAT-2023 (Mum)],*** held that Section 79 of the ITA gets attracted in the year in

which set off is claimed and not in the year when the shareholding of the company changes.

The Proposed Bill addresses this by explicitly clarifying that once there is a change in shareholding beyond 49% compared to the year in which the loss was originally incurred, the right to carry forward and set off the loss is permanently lost. This means that even if the shareholding is later restored to meet the 51% requirement, the ability to utilize the carried-forward loss is not reinstated.

2.2.3. Third key amendment to this section is the removal of the non-obstante clause in the opening part of Section 79 of the ITA. While Section 79 of the ITA begins with "Notwithstanding anything contained in this Chapter," Section 119 in the Proposed Bill does not include a corresponding non-obstante clause.

Notably, Section 72A of the ITA (corresponding to Section 116 of the Proposed Bill) was originally introduced to allow carry forward of losses in case of amalgamation/ demerger, etc. while providing for conditions to prevent profitable enterprises from acquiring loss-making entities solely to utilize accumulated tax losses to offset taxable profits.

While both these provisions appear to deal with different issues, there has been some litigation on whether one will override the other, given that Section 72A of the ITA begins with, "notwithstanding anything contained in any other provision of this Act," whereas Section 79 of the ITA begins with, "notwithstanding anything contained in this Chapter", while both sections fall under Chapter VI - Aggregation of income and set off or carry forward of loss of the ITA. However, since the corresponding Section 119 of the Proposed Bill lacks the non-obstante clause, it will be interesting to see if there arises any situation requiring one to pit these provisions against each other.

2.3. *The Unseen Impact of AMT | A Silent Tax Hike?*

2.3.1. Under the ITA, Alternate Minimum Tax (**"AMT"**) provisions contained in Section 115JC to Section 115JF primarily apply to non-corporate taxpayers such as Limited Liability Partnerships ("LLPs"), partnership firms, individuals, HUFs, AOPs, and BOIs - but only if they claim specific deductions under Chapter VI-A (excluding Section 80P), Section 10AA, or Section 35AD [as per section 115JEE of the ITA].

2.3.2. However, the Proposed Bill introduces a significant shift by extending AMT to all such taxpayers (including partnership firms and LLPs), regardless of whether they claim such special deductions. The widened AMT net could have a significant impact on holding structures where partnership firms and LLPs hold shares in underlying companies. Under the Proposed Bill, LTCG on the sale of such shares would be exposed to AMT at 18.5%, whereas, under normal provisions, the LTCG tax rate is only 12.5%. This disparity can create a disadvantage

for investment vehicles, particularly family offices that pool investments through partnership firms or LLPs.

2.3.3. Interestingly, while the Proposed Bill effectively expands AMT applicability to all partnership firms and LLPs, it appears to inadvertently exclude LLPs that have been converted from companies [Section 206(17) of the Proposed Bill]. This gives a strong impression that the intent is to perhaps leave regular LLPs out of AMT provisions.

2.4. *Fast-Track Demergers | A Roadblock to Tax Neutrality?*

A fast-track demerger, carried out under section 233 of the Companies Act 2013 (**"CA 2013"**), does not require approval of the National Company Law Tribunal (**"NCLT"**) but instead requires clearance from the Regional Director (Central Government). It is a novel introduction under CA 2013 and was absent in Companies Act, 1956 (**"CA 1956"**). Fast-track demergers were introduced to provide a simplified, time-efficient alternative to traditional demergers, primarily benefiting small and closely held companies.

Under the ITA, Section 2(19AA) defines demerger as a transfer pursuant to a scheme under Sections 391 to 394 of the **CA 1956**. The corresponding provisions under the CA 2013 are found in Sections 230 to 232. However, the ITA has not been updated to explicitly reflect this transition, creating ambiguity regarding whether demergers undertaken through new mechanisms introduced under CA 2013 - such as fast-track demergers under Section 233 - qualify for tax neutrality.

The Proposed Bill appears to address this ambiguity, albeit unfavourably, by explicitly recognizing only those demergers carried out under Sections 230 to 232 of CA 2013. By not referring to Section 233 of the CA 2013, the Proposed Bill suggests that tax-neutral treatment may not extend to fast-track demergers. One would have expected a positive approach from the Government in this regard.

3. Set-off and carry forward provisions

3.1. *Transitioning Capital Losses | A Unique Set-Off Opportunity or an Unintended Miss?*

The Proposed Bill largely retains the existing principles pertaining to carry forward and set off of losses in the ITA, ensuring continuity in how taxpayers can utilize past losses against future gains.

Head of income under which loss is incurred	*Head of income under which it can be set-off in the same year*	*Head of income under which it can be set-off in the subsequent year(s)*
House Property	Salary, House Property PGBP, Capital gains, Other Sources, Owning and maintaining race horses Restricted to INR 2 lakhs	House Property

Head of income under which loss is incurred	***Head of income under which it can be set-off in the same year***	***Head of income under which it can be set-off in the subsequent year(s)***
Profits and Gains of Business or Profession ("PGBP")	House Property, PGBP, Speculation business, Capital gains, Other sources	PGBP
Activity of owning and maintaining race horses	Only against income from race horses	Only against income from race horses
Speculation Business	Only against income from speculation business	Only against income from speculation business
Specified Business, as provided under Section 35AD of the ITA [corresponding to Section 46 of the Proposed Bill]	Only against income from specified business	Only against income from specified business
Capital Gains	Short term capital loss ("STCL") can be set-off against any income under the head 'Capital gains' Long term capital loss can be set-off only against LTCG	STCL can be set-off against any income under the head 'Capital gains' Long term capital loss can be set-off only against LTCG
Income from Other Sources	House Property, PGBP, Capital gains	N/A

However, one key transition provision under Section 536(n) of the Proposed Bill (dealing with Repeals and Savings) introduces an interesting anomaly - it allows for the set-off of capital loss (whether related to short term or long-term asset) incurred under the ITA against income under the head 'Capital Gains' under the new law for tax years beginning 01 April 2026.

This modification appears to provide a unique relief to taxpayers having long-term capital losses under the old law, as they can now offset these losses even against short-term capital gains arising under the new regime. Whether this is indeed the intent of the legislature, given that the set-off mechanism is otherwise left untouched in the new provisions, will need to be seen.

4. Conclusion

4.1. As can be seen, the Proposed Bill does not introduce significant policy changes for taxing capital gains provisions. While some of the changes seem patently erroneous and should get corrected before enactment, some other ones (like AMT on LLPs, inter-corporate dividend for 22% CTR companies etc) require better clarity from the draftsmen at the earliest, so that taxpayers have adequate time to take appropriate decisions/actions to address any anomalies at their end.