Additional tax may impact voluntary updated returns

Late voluntary disclosures now come at a hefty price

THE UNION BUDGET has proposed to extend the deadline for filing updated returns from two years to four years. What does this extension hold for taxpayers?

Taxpayers are required to file their income tax returns (ITR) within four to six months from the end of the financial year. For example, for FY 2024-2025, a salaried individual must file their original ITR by July 31, 2025. However, should a taxpayer miss this deadline or discover any omissions or errors thereafter, they have the option to submit a belated or revised return.

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The deadline for filing a belated or revised return is three months before the end of the assessment year, which, in this case, is December 31, 2025. It is important to note that the belated or revised return can be filed without the payment of any additional tax beyond the usual tax amount due.

But, once the deadline for filing a belated or revised return had passed, taxpayers had no means to voluntarily declare any income they may have omitted earlier. To address this gap, the government introduced the concept of an updated return. This allows filing an updated ITR to include any previously omitted income along with payment of additional tax.

Voluntarily declare omitted income

In essence, an updated return allows the taxpayers to voluntarily declare omitted income even after the deadlines for belated or revised returns has passed. This mechanism offers an opportunity to rectify past omissions and avoid potential scrutiny or penalties from the income tax department. Previously, the window for filing an updated return was limited to two years. However, the latest Budget proposes to extend this period to four years, providing greater flexibility for taxpayers to amend their filings.

Further, the proposed amendment not only extends the time limit for filing updated returns; it has also escalated the additional taxes on this late voluntary disclosures. Under the new proposals, an updated return filed within the first 12 months will incur an additional tax of 25%. If filed between 12 and 24 months, this rate increases to 50%. For returns filed between 24 and 36 months, the additional tax is proposed at 60%, and for those submitted between 36 and 48 months, it is set to rise to 70%.

Additional taxes

Suppose a taxpayer realises he has failed to report an income of ₹1,00,000, on which a tax of ₹30,000 and interest of ₹10,000 are payable. They now have the option to file an updated return, with the additional tax payment varying depending on the timing of the filing as calculated below:

Over the past two years, the income tax department has increasingly used data analytics and technology to detect mismatches in reported incomes and third-party data sourced from banks, financial institutions, stock exchanges, among other sources. This has triggered a rise in mismatch inquiries, alerting taxpayers of discrepancies in their filings.

Common issues leading to these mismatches include unfiled ITRs, incorrect deductions claims like house rent allowance or home loan interest, and inconsistent claims under Chapter VI-A, such as deductions for investments or political donations. These inquiries act as a soft nudge for taxpayers, encouraging them to voluntarily file updated returns to avoid comprehensive scrutiny assessments.

Although taxpayers now benefit from an extended window to report omitted income, updating past income tax returns will incur higher tax payments due to the additional tax levied. While this provides a broader opportunity for voluntary disclosures, it raises a critical question: Will taxpayers continue to voluntarily declare the omitted income despite the increased additional tax? Only time will tell.

POWER POINT

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BUDGET OFFERS A WINDOW TO ADD OMITTED INCOME

In the Union Budget for 2022-23, India's finance ministry introduced the concept of updated tax returns to promote voluntary tax compliance. At the time, finance minister Nirmala Sitharaman said that its purpose was to motivate taxpayers to voluntarily disclose any income omitted in their original tax filings.

Three years on, this initiative has seen a significant uptake, with nearly nine million taxpayers opting to update their returns. Building on this success, the finance ministry has now proposed to extend the deadline for filing updated returns from two years to four years.

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Taxpayers are required to file their income tax returns (ITR) within four to six months from the end of the financial year. For the financial year 2024-2025, a salaried individual must file their original ITR by 31 July, 2025. If a taxpayer misses this deadline or discovers any omissions or errors thereafter, they have the option to submit a belated or revised return.

The deadline for filing a belated or revised return is three months before the end of the assessment year, which, in this case, is 31 December, 2025. A belated or revised tax return can be filed without having to pay any additional tax beyond the usual tax amount due. If the deadline for filing a belated or revised tax return has passed, taxpayers had no means to voluntarily declare any income they might have omitted in their ITR. To address this gap and alleviate concerns among taxpayers, the government introduced the concept of an updated return.

In essence, an updated return allows taxpayers to voluntarily declare omitted income even after the deadlines for belated or revised returns have passed. This mechanism offers an opportunity to rectify past omissions and avoid potential scrutiny or penalties from the income tax department, but comes at the cost of additional tax.

Greater flexibility, but at a cost

Updated returns filed within 24-36 months face 60% extra tax; for 36-48 months it is 70%

Previously, the window for filing an updated return was limited to two years from the end of the relevant assessment year. However, the latest Budget proposal seeks to extend this period to four years, providing greater flexibility for taxpayers to amend their filings. Under the new proposal, an updated return filed within 12 months will incur an additional tax of 25%. If filed between 12 and 24 months, this rate increases to 50%. For returns filed between 24 and 36 months, the additional tax is proposed at 60%, and for those submitted between 36 and 48 months, it is set to rise to 70%.

Suppose a taxpayer realises that they have failed to report an income of ₹1 lakh on which a tax of ₹30,000 and interest of ₹10,000 are payable, they now have the option to file an updated return, with the additional tax payment varying depending on the timing of the filing from the relevant assessment year.

In recent years, the income tax department has used data analytics and technology to detect mismatches between reported incomes and third-party data, triggering a rise in mismatch inquiries, alerting taxpayers of discrepancies in their filings.

Common issues leading to these mismatches include unfiled ITRs, incorrect deductions claims like house rent allowance or home loan interest, and inconsistent claims under Chapter VI-A, such as deductions for investments (80C) and political donations (80GGC). These inquiries act as a soft nudge for taxpayers, encouraging them to voluntarily file updated returns to avoid comprehensive scrutiny assessments.

Although taxpayers now benefit from an extended window to report omitted income, updating past income tax returns will incur higher tax payments due to the additional tax levied. While it provides an opportunity for voluntary disclosures, it raises a critical question: will taxpayers continue to voluntarily declare omitted income despite higher additional tax? Only time will tell.

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