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Executive Summary

Positive

- International community has started to acknowledge India's concern on safety after Pokhran blasts.
- Government has amended the Companies Act to allow buy back of shares and issue of Sweat Equity shares.
- Several pro-active issues, steps have been taken to clarify tax and therefore prevent litigation.
- Demergers have been made tax neutral.
- Excise duty rates have been reduced to only 3 - Central rate of 16%, merit rate of 8% and demerit rate of 24%.
- Customs duty rates have also been rationalised.

Negative

- Fiscal deficit continues to be worrying.
- Government is in a debt trap. It has now been accepted by the government.
- Several bills have not yet been passed - insurance, FEMA and prevention of money laundering bills.
- The alliance partners of the government continues to drag the government behind.

II. Direct Tax Provisions

Part A – Tax rates

1. Tax rates

Tax rates have basically not been changed. However, the recession in the economy has hit the finances of the Government badly. To ease the burden on the revenue, a nominal surcharge is proposed @ 10% on incomes above Rs. 60,000/-. Thus the effective tax will be :

Income (Rs.)	Tax (Rs.)
Upto Rs. 50,000	NIL
Rs. 50,000 to Rs. 60,000	10% on income above Rs. 50,000
Rs. 60,001 to Rs. 1,50,000	Rs. 1,000 + 22% on income above Rs. 60,000
Above Rs. 1,50,000	Rs. 20,800 + 33% on income above Rs. 1,50,000

Surcharge has been levied @10% for income above Rs.60,000

Non-resident individuals, non-resident HUFs and foreign companies are not liable to pay surcharge.

2. Long Term Capital gains tax [S.112]

Long Term Capital Gains tax can be paid @ 10% on capital gain without considering indexation relief, if it is more beneficial. Otherwise tax @ 20% can be paid after considering indexation relief.

Residents have to pay a higher tax on long term capital gains on securities as compared to NRIs and FIIs.

Residents are chargeable to tax @ 20%, whereas NRI/FIIs are chargeable to tax @10%. To bring both types of assessees on par, it has been proposed to levy long term capital gain @ 10% in case of securities which are listed on the stock exchange. In such cases the tax is proposed to be levied @ 10%. However no relief on account of inflation will be available. Thus the assessee will have to calculate tax equal to 20% on capital gains by taking into account the inflation. He will even have to calculate capital gains without inflation relief and calculate tax @ 10%. Whichever amount is higher will be payable. It may however be mentioned that NRIs can take advantage of exchange rate fluctuations which cannot be done by residents.

Part B - Major reliefs given

3. Business restructuring

3.1 In the last budget, the Finance Minister had introduced provisions to make conversion of proprietorships and partnerships into limited companies tax neutral. However restructuring of business can take place in several forms. Typically demergers and spin-offs were not teken into account.

Restructuring of business is made "tax neutral".

The government had appointed a committee to look into all the aspects of restructuring so as to make it tax neutral. The Committee had submitted its report to the Finance Minister based on which the budget of 1999 proposes to grant several reliefs whereby restructuring will not have any tax implications.

There are several ways of restructuring eg. amalgamations, de-merges, slump-sale of business units etc. The income tax act contains provisions for granting relief in case of amalgamations. However, for spin-offs or slump-sales there were no reliefs. If any person wanted to sell off his business unit on de-merger of the company, then capital gains or normal tax would apply depending on the manner of selling the unit. The budget has laid down provisions for demerges and slump-sales, and rationalises the existing provisions of amalgamations by adopting the following principles :

Demerger of a unit into a separate company is "tax neutral".

(i) De-merger should be tax neutral.

(ii) Tax benefits and reliefs available to an undertaking, should continue to be available even after the de-merger.

(iii) The accumulated losses, unabsorbed depreciation should be available directly to the undertaking which is proposed to be transferred.

(iv) There should be clarity in law regarding tax implications on slump-sales.

All assets and liabilities of undertaking must be transferred to the resulting company.

3.2 Demergers [Ss. 47, 2(19AA) etc.]

3.2.1 Some of the salient features for granting reliefs for demergers are as under :

(i) All the properties of the undertaking which is proposed to be transferred should become the properties of the resulting company.

(ii) All liabilities related to the undertaking should be transferred to the resulting company.

(iii) The properties and the liabilities should be transferred at book values appearing in the accounts immediately before the demerger.

(iv) The resulting company should issue shares to the shareholders of the demerged company - eg. say a company "D" (Demerged company) transfers a business division to company "R" (Resulting company), then the company "R" should issue shares to the shareholders of Company "D".

(v) 75% of the shareholders of the demerged company should become shareholders of the resulting company.

(vi) The transfer of the undertaking is on a going concern basis.

Thus primarily, if an undertaking which includes all its assets and liabilities is transferred as a whole, then on such a transfer, there will be no tax on the same. It should be specifically noted that individual assets or liabilities cannot be transferred. Only a business unit as a whole should be transferred. It is like breaking up of a piece of cake and transferring one piece in another basket. In such a case, there is no real increase in the property, therefore there should be no capital gains.

3.2.2 A business undertaking may mean any factory, a branch etc. If a company has three processes and it wants to demerge unit involved in one process, it may be able to do so. It should be capable of saying that it is one business unit being capable of working independently.

3.2.3 This relief is available only to companies, authorities of the government, PSU etc. It does not apply to non-incorporated persons.

3.2.4 There are certain restrictions and guidelines for such demergers to be tax neutral. Some of the main restrictions are mentioned below:

(i) The demerger should take place pursuant to a scheme of arrangement u/s. 391 to 394 of the companies act. These provisions of the companies act require general body approval of the shareholders and also approval from the High Court.

(ii) In case there are any general or multipurpose borrowings in the demerged company, the same should be transferred to the resulting company in the proportion of the value of the assets transferred.

(iii) Any revaluation amount of the assets before the demerger should be ignored.

3.2.5 The provisions also take care of certain issues which can arise on such demergers.

All reliefs related to undertakings which are spun off will be available to the new company.

(i) The depreciation which is available to demerged company will now have to be split between the demerged company and the resulting company. It will depend on the number of days that the assets were used by the two companies.

(ii) The relief available in case of amounts paid for acquiring patents will now be available only to the resulting company.

(iii) Similarly, in case of payments for knowhow, the deductions will be available to the resulting company instead of the demerged company.

(iv) Deduction for preliminary expenses will now be available to the resultant company instead of the demerged company.

(v) Reliefs available in case of shipping business or prospecting of mineral oils, will be available to the resultant company.

(vi) The losses related to the undertaking will now be available to be carried forward and set off in the resultant company.

3.3 **Slump Sale [Ss. 2(42C),50B]**

Capital Gains on slump sale is taxable as long term capital gain.

3.3.1 As in case of demerger, in case of slump-sale of an undertaking the budget now proposes to treat the same as long term capital gains. Even in case of slump sale, a business unit has to be transferred. The business unit will comprise of several assets. However the same should not be sold individually. The entire unit should be sold.

3.3.2 Earlier, there were several controversies regarding the tax on such slump sale considerations. In the case of Syndicate Bank (155 ITR 681), it was held that

the business is sold as a whole. One cannot allocate the cost of the undertaking various assets as the assets are not sold. It is the entire business unit which is sold, and as the cost cannot be determined, there cannot be any tax on capital gains tax. This principle was laid down in the case of Srinivasa Shetty - 128 ITR 294.

However, there are decisions which are contrary to the above decision. They hold that the sale consideration can be split between the various assets which are transferred as a part of the undertaking and appropriate capital gains can be levied on the same. This created a lot of ambiguity and disputes regarding the tax treatment. Now, the budget proposes to clarify the situation by providing that the slump sale of business unit will be treated as long term capital gain transaction - if the undertaking is held by the assessee for atleast three years. This is again a positive step by the Finance Minister where he has brought out clarity in the law. The fact remains that on sale of any unit there can be capital gains or capital losses. However, due to the difficulty in finding out the cost, the assessees used to take a view that there will be no tax.

3.3.3 The amendment also clarifies that in case the value is determined for individual assets for stamp duty purpose, that will not be regarded as assigning the values to specific assets. This again is a welcome provision.

3.3.4 The amendment provides that the cost of the undertaking shall not be indexed. Therefore, tax on capital gains will be levied without considering the inflation relief. While the undertaking may be held for three years, it may be difficult to find out the costs which have gone into it. Indexation has to be done from the year in which the costs have been incurred. As the undertaking is sold as a whole, the Government has thought it fit to ignore the inflation relief. In fact it is possible that some costs may have been incurred not earlier than three years. Yet the whole capital gain will be considered as Long Term Capital Gain.

There is a further relief available indirectly. Consider this example.

	For I.T.	For Accounts
		Rs. Crores
Cost of the undertaking	10.00	10.00
Less: depreciation for 3 years rate	25%	14%
amount	5.78	3.64
Net WDV	4.22	6.36
Sale	15.00	15.00
Less: Cost	6.36	6.36
Capital Gain	8.64	8.64

Total deduction allowed for income tax:

Depreciation	5.78
Cost of undertaking	6.36
	12.14

This is more than the cost of the undertaking. By providing for cost as net worth of the undertaking, more deduction is available than what has been spent. There is of course a difficulty in determining the cost of the undertaking. This is discussed below.

3.3.5 The budget provides that the cost of the undertaking will be the net worth as defined in the Sick Industrial Companies Act. As per the act, net worth means share capital plus free reserves. This definition can apply only to companies. It cannot apply to an undertaking as the undertaking cannot have "share capital or free reserves". It cannot apply even to a firm or any person which is not a company. It should be provided that the cost of the undertaking will be net book value of assets (less liabilities) as in case of demergers.

The definition of cost of undertaking will have to be modified to make the slump sale taxation workable.

3.3.6 For determining the date of acquisition of the undertaking there can be a difficulty. This will determine whether capital gain is long term or short term. In case of those undertakings which are acquired, it may not be difficult to find out the date of acquiring the undertaking. If however, the undertaking is set up it can be a difficult issue. e.g. If someone sets up a large cement plant, then will the date of commencement of commercial production

be considered or will the date of trial production be consider or will the date of certificate from the legal authority for commencing the plant be considered? There could be several views on this issue. There, if some clarifications could be issued by the government, that could be helpful. A logical date would be date of commencement of business of the undertaking.

3.3.7 Unlike demergers, the clarification regarding taxability in case of slump sale is applicable to all assessees.

4. Housing Sector

To encourage housing development the budget proposes several measures for - recovery of loans, availability of funds to housing sector, etc. Tax reliefs are also proposed as under :

Reliefs have been given for housing sector.

4.1 Interest on borrowed funds [S.24(2)]

Interest on loan for houses can cause a major outflow of funds - specially when it is not tax deductible. A businessman can get a deduction for interest on business loan from his income.

However, a salaried person (or even a businessman) does not get full relief for interest on loans for houses. A person gets full deduction for interest only if the house is given on rent (which is quite risky by itself). For self-occupied property, a deduction of a maximum of Rs.30,000 is available on account of interest. The budget proposes to increase the amount of deduction to Rs.75,000/-. The additional deduction of Rs. 45,000 can reduce the tax between Rs. 4,500 and 14,850 depending on the tax bracket.

Interest on housing loans taken after 1.4.99 are deductible upto Rs.75000.

This is substantial relief. Assuming an interest rate of 15% p.a., interest on loans upto Rs.5 lakhs will be fully deductible.

Two conditions need to be fulfilled :

- The loan should be taken after 1.4.99 and
- The house should be acquired or constructed prior to 31.3.2001.

Yet this relief is not adequate for cities like Mumbai and Delhi. A flat of 600 square feet in Mumbai or Delhi can cost Rs. 15 lakhs or more. For these cities atleast, a higher limit can be considered.

In fact for persons undertaking housing developement, relief is available under section 80-IA. (See para 4 below). If the housing project is in Mumbai or Delhi, the relief is available for flats upto 1,000 square feet. For other cities, it is 1,500 sqaure feet. The government recognises that costs in Mumbai and Delhi are higher. Therefore people can afford smaller houses as compared to other cities. However, for interest on housing loans, this difference is not recognised.

Further, for repayment of housing loan, relief under section 88 is available only upto a repayment of Rs. 10,000. It is necessary to increase this limit.

4.2 Letter addressed to Honourable Finance Minister is reproduced below

Date : 13th March, 1999

Honourable Shri Yeshwant Sinha,
Finance Minister of India,
Government of India,
New Delhi.

Your Excellency,

Sub : Post Budget Requests
Direct taxes

We are sending herewith our suggestion for direct taxes.

Housing Loan.

1. **Interest Payment**

You have very kindly proposed to exempt interest paid on loan taken for purchase of residential house. It is recognised that houses in metropolitan cities like Bombay and Delhi are different from houses in other non-metropolitan areas. Hence, the area permitted for Bombay is lower as compared to other areas.

For Bombay a flat of 1,000 sq.ft built-up area is permitted.

Even under the current recessionary situation and even in the farthest suburb - Borivli, the going

rate for ownership residential premises is between Rs. 2,000 to Rs. 3,000 per sq.ft. At this rate, the minimum price for a flat will be Rs. 20 lakhs.

The rate of interest charged for a loan of Rs. 15 lakhs is normally 15% p.a.

The interest payable for this loan to H.D.F.C or any other bank, financial institution etc. will be atleast Rs. 2,25,000 per year.

As against this interest, the finance bill proposes to exempt only Rs. 75,000 per year. This amount can cover only a loan of Rs. 5 lakhs.

At Rs. 5 lakhs, a person cannot buy a flat anywhere in Bombay.

In the circumstances, I suggest that the upper limit on interest payment should be omitted. As long as a person is borrowing from a recognised housing financial institution, or his employer, there should be no upper limit.

2. **Loan Repayment**

Under S.88, installment repayment of housing loan is permitted for tax relief. Here also, there is a limit of only Rs. 10,000 per year.

Real boost to Housing Finance Sector can be provided if even this limit is omitted. As long as a borrower in India is repaying his loan to a recognised financial institution or to his employer, there should be no limit on how much relief he may claim under S.88. Both the limits of Rs. 10,000 as well as 60,000 should not be applicable to housing loan repayments.

I sincerely request you to please consider this suggestion while finalising the budget proposals.

Thanking you,

Yours faithfully,

Rashmin Sanghvi.

4.3 Taxation of income of housing finance companies [S.43D]

Income of housing finance companies (HFC) are taxed normally on accrual basis. Accrual basis is a normally accepted accounting system for taxing

the income. However, in case of Non-performing Assets (NPAs), this can create a difficulty. There may be an uncertainty of getting the income, yet the income will be taxable. (Under the Income-tax Act, provision for bad debts is not allowed as a deduction. Actual writing off of debts is only allowed).

The budget proposes that in case of NPAs, income will be taxable only in the year of receipt or in the year in which the company credits its profit & loss account whichever is earlier. It will not be taxable on accrual. This is logical. It will prevent taxation of uncertain income. Thus HFCs have now been put on par with Financial institutions and banks.

5. Infrastructure

The Government of India has laid down emphasis on building up infrastructure in this country. Several tax reliefs have been provided to various sectors of infrastructure over the past few years. Even this year, the relief to be given to infrastructure industry has been expanded to cover a few more sectors :

Infrastructure reliefs are extended to certain other activities.

5.1 Power Transmission and Distribution [S. 80-IA]

In case of power sector, private sector was allowed only in generation. Therefore relief was also provided for generation, or genaration and distribution. Now even power transmission and distribution has been opened up for the private sector (i.e. without generation). Therefore, relief is proposed to be given in case of assessees who set up power transmission and distribution facilities. The relief is available if the assessee starts transmission or distribution by laying a network of new transmission or distribution lines between 1.4.99 to 31.3.2003. Relief will be available by way of a complete tax holiday for the first 5 years and thereafter relief will be available @ 25% of the profits for the next 5 years. In case of companies, relief is available @ 30% of the profits for next 5 years.

5.2 Relief so available in case of persons setting up Cold Storage Plant [S. 80-IB]

For distributing agricultural produce there needs to be an entire cold storage chain so that the produce can reach from the land to the consumers in consumable condition.

For this, tax relief is proposed to be given to cold storage chain facilities which help in storage and distribution of agricultural produce. The relief proposed to be given is a complete tax break for the first 5 years and thereafter 25% in the subsequent 5 years. In case of companies, relief is available @ 30% of the profits for next 5 years. However, this relief is available only in case of storage or transportation of agricultural products. It is not available in case of other items like dairy products, meat products and poultry products.

5.3 Financing of Venture Capital Business[S.10(23G)]

Relief is available in case of dividends, interest and long term capital gains to infrastructure funds and companies. It is available in case if they finance any enterprise carrying on a business of developing,

maintaining and operating any infrastructure facility. However, it is possible that one enterprise may not do the entire activity of developing, maintaining and operating the infrastructure facility. For example, a road or a bridge can be built by one enterprise and operated by another enterprise. In such a case, it was possible to take a view that relief will not be available to the financers. The budget now proposes that the enterprise can do any of the activity pertaining to infrastructure. It can either be only development, or only operation or development and operation both. Relief will be available in all the cases.

In case of films, music, etc. no relief is proposed for supporting exporter.

Also, the definition of infrastructure facility has been extended keeping in line with the amendments made in case of relief for the enterprise operating the infrastructure facilities. Now, it includes transmission and distribution of power, housing project, etc.

6. **Film/TV programme exports [S.80HHF]**

Profits on export of film software, music software, & telecast rights will be tax free.

Relief is granted to exporters of goods and software. The budget now proposes that relief will be granted to export of film, music, telecast rights, TV news, TV programmes, etc.

The section provides that :

- the film, TV software, etc. can be exported through any medium - direct, satellite, cables, etc.

- Export proceeds should be received in foreign exchange within 6 months from the end of the year. The period can be extended by RBI.

- The film should be certified by Central Government under Cinematograph Act 1952.

- Relief will be available only to Indian companies. It will be available to non-incorporated bodies as in case of export of goods or software.

The budget provides 100% tax relief to such exports.

There are however two issues.

Relief for export of goods and software is available to supporting exporter of goods and software i.e. If a person sell goods or software to the main exporter,

who in turn actually exports the goods or software, then relief is available to such supporting exporter. Further relief is available only to companies. Whereas in case of goods and software, relief is also available to unincorporated entities.

Both the issues should be considered and relief should be provided.

7. **Dividends on units of UTI and other mutual funds [S. 10(33), Chapter XII-E]**

Dividend on units of UTI & mutual funds is tax free. UTI/Mutual funds will tax @ 10% on dividends distributed.

7.1 Dividend on shares were given exemption from tax two years ago. Now dividends on UTI schemes and mutual funds are also proposed to be made tax-free.

In its place, UTI and mutual funds will pay tax @ 10% on distributed dividends.

Open ended equity oriented funds are however exempt from tax of 10% for a period of 3 years upto 31.3.2002.

7.2 Open ended equity oriented funds means

- Unit Scheme 1964 of UTI
- Such funds where more than 50% of the total proceeds of the fund are invested in Indian equity shares.

Thus it does not mean an open-ended fund where investors can buy and sell units anytime. The investment in equity shares is relevant.

7.3 This will again go in simplifying the taxation of individual taxation. At the same time, it will be easier for government to collect taxes.

7.4 Most of the issues which applied when dividend of shares were made tax-free, will apply even for mutual fund dividend.

8. **GDRs of resident employees (S.115 ACA)**

Income on GDRs issued to resident employees is taxable at concessional rate of 10%.

Software sector has performed exceedingly well. This is one industry which has performed without any substantial help from the government (except perhaps 80HHE relief).

Some time ago, RBI had allowed employees of software companies to purchase GDRs of the employer companies by remitting funds in foreign currency.

The budget now proposes that if the employees earn dividends (other than tax-free dividends), the same will be taxable @ 10%. Similarly, long term capital gains will be taxable @ 10%. Consequently, no deduction, inflation relief or Foreign Exchange fluctuation relief will be allowed.

This relief is available to employees of companies engaged in information technology software and information technology services.

The GDRs should be issued pursuant to Employees stock option scheme to be notified by the Government.

In case of employees, who become non-residents, the relief may not be available.

9 **Mediclaim [S.80D]**

Relief for payment of mediclaim premium is available upto Rs.10,000/-. The budget proposes that for senior citizens (above 65 years of age), will get relief upto Rs.15,000/-).

Part C - Other important clarifications

10. Forward looking steps

With emerging business issues, there also emerge tax issues. The Government has taken several pro-active steps to clarify issues which otherwise could have remained controversial. Some important issues are explained below:

Government has clarified some issues which could have lead to litigation.

10.1 Electronic Commerce

Electronic Commerce is growing phenomenally. It is possible today to buy several products, software and services over the internet. An illustration of the way the transactions can take place is given below :

A person may be doing business in U.K. He could have leased a server in U.S.A. on which he could have loaded his software. A person in India could log on to the server in U.S.A. and download the software. The payment for the same could be made from a fourth country. Where will the profits be taxable? All countries could lay claims. How should the tax be shared?

The issue does not raise just the tax issues, but also contractual and legal issues. Though this budget does not deal with this issue, but it may be worthwhile to note the steps taken by the Government in the past.

This problem is being dealt with by all the countries. No one has yet found a solution. Government has appointed a committee to enact Cyber laws. It will lay down how electronic contracts can become legally binding on the parties. India will be among the few countries which can have its own E-commerce law. The draft law is already ready. After the debate within the government, it should be passed within a short period.

10.2 Buy Back of shares [S. 2(22) and S.46A]

Buy back of shares will give rise to capital gains and not dividends.

Some time ago, the Government had allowed companies to buy back its own shares. On buy back
of shares the company pays to the shareholders the market value of the shares.

There were two views. One view was that the buy back of shares would give rise to capital gains in the hands of the shareholders. It will be taxed

accordingly. The other view was that the amount paid back would amount to refunding a part of the reserves by the company. In such a case, it will be dividend. There will be no tax payable by shareholders, but companies will be liable to pay tax of 10% on distributed dividends.

Though in our view the buy back would give rise to capital gains, there could be disputes. The budget now clarifies that buy back of shares will give rise to capital gain or loss as the case may be. It has laid to rest any dispute which could have arisen.

It should be noted that if shares are held as business assets, then the buy back of shares will give rise to business income or a loss.

10.3 **Y2K expenses [S. 36(1)(xi)]**

Y2K expenses incurred between 1.4.99and31.3.2000 can be claimed as revenue expenses.

The change of year from 1999 to 2000 is expected to have problems in different areas. The problem has its genesis a few decades ago when the memory and storage space were expensive. Coupled with this was programmers' reluctance to provide for all four digits of a year. Therefore, the dates were written with year being represented by two digits. e.g. 1999 is referred to as 99 only. On change over to year 2000, the same will be referred to as 00. This can give rise to various problems in banks, insurance companies, medical systems, transportation systems, etc. All sectors which use or require dates in periods accross two centuries can face problems.

Several companies will have to spend billions of dollars to change their systems, hardware and software. Further change of systems may involve buying of new and modern hardware as old types of machines may not be available. If large sums are incurred, the tax department may take a view that it is capital expenditure and not revenue expenditure.

In our view, the same is revenue expenditure. To take an example, the law requires that old cars should be fitted with catalytic converters. The converter is an asset. However, it does not improve the capabilities of a car.

Therefore, the expenses should be treated as revenue expenses. Similarly, expenses incurred to take care of any system which may not work or malfunction, are revenue in nature. To avoid any controversy, the budget provides that expenses for

making a system Y2K compliant will be treated as revenue expenses. Even if the expenditure is of capital nature, the same will be fully allowed.

However, the budget provides that expenses incurred between 1.1.99 and 31.3.2000 will be treated as deductible. There are businesses which have already incurred expenses prior to 31.3.99. Further there are businesses which will have to incur expenses much after 31.3.2000. For such cases, there may be an avoidable controversy. The budget could have provided for the treatment as revenue expenses without any time limit.

10.4 Employee Stock options and Sweat Equity shares -[Ss. 17(2)(iiia) and S.49(2B)]

10.4.1 Stock Options

Employee stock option taxation has been clarified.

To encourage employee commitment, companies offer stock options to their employees. Typically the option works this way :

	Rs. per share
Option may be given to buy shares in year 1	100
Market price at the time of giving the option	200
Employee exercises the option in year 3 and buys shares @ Rs.100/-	
Market price in year 3 at the time of exercise of option	400
Employee sells the shares in year 5 Market value at that time is	500

What will be the tax?

The possible views were :

(i) The value of the option is year 1 is Rs.100 (market value - option price).

Tax it as perquisite at normal rates. Here however, the employee does not received cash. To pay tax he may have to generate resources. Further the employee may not buy the shares if prices fall. This may result in tax where the employee has not received any benefit.

(ii) The value of the option in year 3 is Rs.300 (market rate in year 3 - option price).

Tax Rs.300 as perquisite at normal rates. Here the employee gets a share at a discount of Rs.300/-. It is fair to tax him in year 3. Only he may have to generate resources to pay the tax. (There will of course be TDS deductible by the company but the employee may not have that much salary available to his credit).

(iii) The gain of Rs.400 in year 5 should be taxable as capital gains.

The employee realises the proceeds and he can pay the tax. However, by that time, the employee may have left the company. Further stock option is only a way of giving benefit to the employee. The benefit to an employee is salary.

A fair way had to be found out.

The budget clarifies that, value of the security will be taxable in the year in which the employee exercises his option i.e. in year 3 in the above example. The difference between the fair market value of the securities and cost for acquiring the shares will be taxable i.e. Rs.300 will be taxable.

10.4.2 **Sweat equity shares**

Sweat equity shares are issued to certain employees and promoters at a discount to the market value. These may be key people in the company. CBDT had clarified that shares issued to employees at a discount will be taxable in the year of issue. The difference in the fair market value and the cost will be taxable. Now, this has been provided in the act itself.

The provision applies to employees of private and public limited companies. In case of Public companies, fair market value will be the price quoted on the stock exchange. In case of private limited companies, the price will have to be worked out on appropriate valuation method.

10.4.3 **Break-up between perquisite and capital gain**

It was possible that there could be double taxation. In the above example, on sale of shares, the capital gain could be worked out as Rs.400 (sale price minus cost). In such a case the total income would be:

Perquisite	Rs.300
Capital gain	Rs.400

Taxable Total Income	Rs.700
	=====

The actual gain to the employee is only Rs.400/- (Rs. 500- 100). This is because, perquisite value of Rs.300 has been already taxed and for capital gain again the cost is considered as only Rs.100/-.

Now, the budget provides that the cost of the shares will be considered as fair market value at the time of exercising the option. Thus in the example, cost will be Rs.400/-. Capital gains will be Rs.100/-.

However, for sweat equity shares this clarification has not been given.

In brief the budget provides for a clear break-up of the taxability of gain of Rs.400/-.

	Amount Rs.	**Year**
As Perquisite	300	3
As Capital gain	100	5

TOTAL	400	
	===	

Internationally, this is the accepted way of taxing stock options.

11. **Salary earned by a non-resident [(S-9(1)(ii)]**

In case of employees of foreign companies who render services in India, the same is taxable in India. However in case of oil rigs, normally the employees are given special incentives. Typically for every day of work, they are given one day holiday. They get frequent holidays which they utilise by staying in their home country. Salary is payable for such leave. Some assessees contended that salary for leave period or rest period is not taxable. The budget now clarifies that such income will be considered as salary earned in India and therefore taxable, as primarily it pertains to services rendered in India.

12. **Assessment [S.143(1)]**

Power of Assessing officers to make adjustments to the total income and levy of additional tax is removed.

The current provisions mention that, when a return is filed by the assessee, the assessing officer should send an intimation to the assessee. The intimation can mention the demand or the refund due. Further, the assessing officer was granted powers to make prima facie adjustments before sending the intimation. This "prima facie" adjustment results into disputes. What is "prima facie" adjustment has not been defined. e.g. expenses claimed as revenue were treated as capital and were disallowed.

Such issues are always arguable and without giving an opportunity to the assessee, the adjustment was made. Further, if any addition to income was made, additional tax was also payable.

The budget now makes the following changes.

No adjustment can be made except for calculation of granting of credits for taxes. If there is no tax payable or no refund receivable, the acknowledgement of the return will be considered as intimation i.e. no separate intimation will be sent.

This will go a long way to reduce litigation.

13. **Lease income earned on lease of aircraft or aircraft engine [Ss. 10(15A), 10(6BB)]**

Lease income on lease of aircraft and aircraft engines is tax free if agreement is entered into after 31.3.99.

Foreign Government and non-residents are exempt from tax on lease income earned by leasing an aircraft or an aircraft engine. The relief was introduced w.e.f. 1.4.96 (A.Y.96-97). This relief was restricted to agreements entered prior to 1.4.97 [S.10(15A)].

For agreements entered after 1.4.97, (where the lease income is taxable), relief was given for tax on tax of lease income (i.e. if tax was payable on such income of non-residents by the Indian company, there was no grossing up of tax). [S.10(6BB)].

The budget now proposes that lease income will be exempt from tax if agreements are entered into prior to 1.4.97 or after 31.3.99. Correspondingly, the relief for grossing up of tax is removed as it is no longer required.

However, income for which agreements have been entered into between 1.4.97 and 31.3.99, remain taxable. It may be noted that it is not the income earned between 1.4.97 and 31.3.99 which is taxable, but income for which agreements are entered between 1.4.97 and 31.3.99 are taxable. Hence, they will continue to be taxable till the agreements expire.

The tax on such income will be considered as business income and tax @ 48% will be leviable on net income.

14. **Clarification from RBI for payment of tax**

Reserve Bank of India gives a lot of data and information. There Website is http://www.rbi.org. One such important press release is given below. It has been downloaded from “Press release” section.

III. Part Gold Bonds

1. Gold is Indian citizens' most important investment item. Over the centuries it is estimated that there are thousands of tonnes of gold with Indian citizens. We are the largest consumers of gold as a country in this world. In 1998, we imported 800 tonnes of gold amounting to over US$ 8 billions. This is more than the import of petroleum products. Our trade deficit is about this much. This is a huge expenditure. To mobilize gold lying idle with citizens, the government has announced gold deposit scheme. Details are yet to be announced.

Gold imports cost U.S.$ 8 billions which is almost equal to trade deficit.

2. The citizens will be able to deposit gold with banks just like cash. Against the Gold Deposit, certificates will be issued. After a specified period, the person will get back the gold. The deposit will earn a nominal interest which will also be paid in gold. There will be no tax on such interest. There will also be no wealth tax on such gold bonds. The bank in turn will onlend gold to gold jewellers at an interest. The government hopes to save on import of gold.

3. **It should be noted that it is NOT an Amnesty Scheme.**

4. Government intends to bring idle gold into circulation. Just like cash lying idle at home and not earning anything is not of much use to the economy, similarly gold lying idle does not earn anything. In fact to keep the gold, one has to incur cost for safety and insurance. By opting for the scheme, one can be relieved from the botheration of security. At the same time, interest can be earned.

5. **Cash Savings – To – Banking system**

There was a time when, people had no good instruments for storing their savings. They would put the cash in a pot & bury it in their house or farm etc.

Success of the scheme will depend upon the entire package.

Banking system has changed all that.

Tremendous amount of progress in the economy has been possible only because of banking.

Gold Savings – To – Gold Bonds

A similar amount of savings can be achieved by the Indian economy if the Gold Bond Scheme really becomes popular.

Initially, people will not trust. It was difficult to tell a farmer to scrap his pot & go to bank.

It is difficult to tell Indian ladies to hold "bonds" instead of "Lagadis"

How to break this initial resistance, is a big issue.

6. **Risks**

As usual, every investment has its own risks. The bank which one selects should be sound. If the bank is aggressive, then it is liable to take more risks. They may lend to borrowers who may not have best of the credentials. Such bank can go insolvent and result into loss of gold.

Again it is similar to cash. If banks go insolvent, one may lose money. Hence selection of a bank will become important.

7. Previously also the government had announced Gold Bond schemes. The schemes however had failed. At that time, Gold was not free from controls. No one could own pure gold. Only jewellery could be owned. Now there is no gold control. Any person can own pure gold biscuits.

A major portion of the import goes into jewellery. Economically gold is not of much use. Yet gold has been used since ages in India as the store of wealth. When gold trading was restricted, the trade went underground. Realising this, the government opened up the import. This has resulted into gold being imported officially.

8. Government hopes to recycle the gold which is lying with the Indian household.

Though the scheme is laudable, a lot will depend on its marketing. Several people have advocated that without an amnesty, the scheme may not succeed. However even the earlier schemes were under amnesty categories. Yet they did not succeed. Against that, SBI issued Resurgent India Bonds in 1998 without any amnesty benefits. It gathered US$ 4.2 billion against a much lower target. Therefore,

it will largely depend on the total package of the Gold deposit scheme.

9. Some problems which can prevent people from opting for the gold bond scheme are :

- attachment towards jewellery,

- loss on sale of jewellery (conversion/making charges). The bank which accepts jewellery will onlend it to jewellers. The jewellery will be melted. The loss on the same will have to be borne by the depositor. It is a loss in any case. The issue is of recognising and accepting the loss.

- on maturity of the deposit, one will not get same jewellery. One will get gold.

The pre-requisites for the success could be :

- correct assaying of gold and jewellery.

- credit worthiness of the bank accepting deposits. If a weak bank accepts gold and it becomes insolvent, it can create a problem.

- Correct systems of onlending the gold by the banks - the jeweller's credit worthiness.

If by recycling the gold, India can save a few billion dollars, it will reduce the deficit to some extent.

10. **Gold in crisis**

While gold as an investment has lost its shine, it can be useful in times of crises. It is reported that due to Y2K problem, some of the American investors have invested in Gold. Currently, the economic situation in this world is delicate. Beginning in 1997, the currency crisis has spread to several parts of the world. In 1997, the South East Asian countries were hit by the crisis. The problem spread to Russia in 1998. From there it has spread to Brazil. Japan is in a financial mess. China's economy is struggling to keep the high pace. There are news reports of the bubble bursting in China. In the U.S., the stock market has been growing for the past 9 years. The valuations are at historic highs. Internet has facilitated speculation by sitting at home. Several persons are reported to have left their jobs to sit on the net and trade. All these are signs of growing differences between reality and perceptions.

If these are not corrected in time, then the bubble may burst. As it happened in the South East Asian countries. People started thinking that the economies will keep on growing. The reality and perceptions were different. The gap increased beyond sustainable level. The inevitable happened in South East Asia in 1977. It may happen in U.S.A. in near future.

11. The Indian situation is also bad. We are in a debt trap. It has been accepted by the Government. However in South East Asia, the people did not see the problems. If one had investigated into the economic data (as Mr. Paul Krugman had did), he would have realised that there were severe defects in the system. In India, atleast we know there is a problem & the Government hopefully will take steps to improve the situation.

IV. Summary

To achieve higher levels of income, there are several hurdles to be overcome. We are confident that we have the necessary resources and the people with which we will achieve the objectives.