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Dear Reader,

Sub: Finance Bill 2016 – Income-tax

This Government presented its third Finance Bill on 29th February 2016. The Government has taken some concrete steps during the past two years to bring in clarity in the Income-tax Act. It appointed committees to look into controversial and difficult issues. Wherever issues were controversial, the Government has brought in circulars and given its view - in some cases, clearly in favour of tax payers.

In this finance bill also, there are measures to bring in clarity. The direction is good. We appreciate that Income-tax law is a complex legislation with several objectives. To balance the same is a difficult job. In the circumstances, we consider the direction of the finance bill good. We hope it will continue in future as well.

We have given our analysis of the important provisions in the Finance Bill 2016 relating to Income-tax. Needless to say, this is continuing exercise. As we go along, we will have more clarity.

We will glad to receive your feedback and observations.

Rashmin Sanghvi and Associates

Analysis of Key Income-tax Provisions of

Finance Bill 2016

Index

Finance Bill 2016

This document contains our analysis of the key amendments proposed by the Finance Bill 2016. This note also considers amendments to the Finance Bill made on 29th April 2016. Finance Bill has been passed in the Lok Sabha. It has to receive President's assent. Therefore this note refers to the Finance Bill provisions as proposals. These can be considered as final. All these amendments apply from FY 2016-17 (AY 2017-18) unless otherwise stated.[1]

The section numbers given in the paragraph titles refer to sections of the Income-tax Act. In some cases, we have given reference to the clauses of Finance Bill 2016.

We have attempted to explain the provisions in non-technical language so that it is simple to understand. Many provisions have conditions to be fulfilled. There could be some issues and controversies. We have given only the important issues associated with the provisions as otherwise it will make the analysis unduly long. Before taking any decisions, professional advice should be taken. The reader should not take any decision based on this document.

[1] This time quite a few provisions are made applicable from a future year and hence care needs to be taken of such amendments which become part of the Finance Act 2016.

Chapter A - Tax Rates, Tax reliefs & Future Scenario – Broad Policy

1. Rates of Income-tax:

1.1 In the previous Budget speech, the Finance Minister had proposed to bring down corporate tax to 25% in the next 4 years combined with removal of tax exemptions. He has made a beginning with the following measures:

i) A company set-up and registered after 1st March 2016 and engaged in business of manufacturing and production, may opt to be taxed at 25% subject to fulfillment of some conditions. [S. 115BA]. (See para 2 for more details.) If the companies do not opt for 25% tax rate, they will be taxed like any other company.

ii) Corporate rate of tax in case of domestic companies has been reduced from 30% to 29% provided total turnover or gross receipts of the company does not exceed Rs. 5 crores for the financial year 2014-15.

iii) Profit linked/weighted deductions, accelerated depreciation deductions are being phased out with dates announced in advance. The deductions having a sunset date will continue till that date. However, where no terminal date is provided, sunset date will be 31st March 2017. (see Annexure II for details).

1.2 Tax on dividend has been introduced for shareholders who earn dividend of Rs. 10 lakhs or more from dividend declared by Indian companies. This will apply to individuals, HUFs and firms. (see para 3 for more details.)

1.3 The tax rates for FY 2016-17 are given in Annexure I.

2. Tax rate on new companies: [S. 115BA]

As mentioned in para 1.1 above, the Government wants to remove deductions and lower the corporate tax rates.

2.1 A new Indian company set up and registered on or after 1st March 2016 is eligible for a lower rate of tax of 25% (plus surcharge and education cess) instead of the 30% rate applicable for other companies. Only a company engaged in the business of manufacturing or production of any article or thing is eligible for this relief. The lower rate is applicable from Financial year 2016-17 onwards. The present lower tax rates for short term gain on some assets like equity shares and certain units, and long Term gain will continue. MAT will also continue to apply.

2.2 Such a company needs to compute its income as under:

i) The company is engaged in the business of manufacturing or production of any article or thing and research in relation to, or distribution of such article or thing manufactured or produced by the company. Other businesses like services, software, etc. are not eligible.

ii) None of the following reliefs can be claimed by the company

a) relief for units in SEZs.
b) accelerated depreciation for new machinery.
c) deduction for new machinery cost of which exceeds Rs. 100 cr.
d) deduction for new machinery in backward areas of Andhra Pradesh, Bihar and West Bengal.
e) deduction for special bank deposits for those who are engaged in growing and manufacture of tea, coffee or rubber.
f) deduction for special bank deposits for those who are engaged in prospecting for, extraction of production of petroleum and natural gas.
g) weighted deduction for expenditure on scientific research.
h) expenditure for approved projects for social and economic welfare.
i) deduction for capital expenditure for pipelines, hotels, housing projects, etc.
k) weighted deduction for expenditure in skill development.
l) deductions under Chapter VI-A infrastructure relief, etc. (The only deduction allowed is u/s. 80JJA for new employment. See para 7 for details.)

iii) No loss can be carried forward from any earlier assessment year if such losses are attributable to any of the deductions referred to in clause (ii) above.

iv) Depreciation is determined in the manner as may be prescribed.

2.3 To avail the benefit of 25% tax rate, the company needs to exercise this option before the due date of filing its <u>first return</u>. If it does not exercise this option in the first year, it cannot do so in subsequent years. Once the company opts to be taxed at 25%, the company cannot subsequently withdraw the option in any year.

It may choose not to exercise this option if it considers that going under the normal provisions may be better.

3. Tax on dividend: [S. 115BBDA]

3.1 Under the current law, dividends paid by a domestic company are subject to Dividend Distribution tax (DDT). This DDT is levied irrespective of the income of the person receiving the income. Such dividend is exempt in the hands of the shareholders.

3.2 It is now proposed to levy a tax @ 10 % on the dividend income earned over and above **Rs. 10,00,000** by **a resident individual, HUF, firm or an LLP**. No expense can be claimed against the dividend income earned.

In effect, those who undertake business through a company, will be liable to **tax at three levels** – first as tax on corporate profits; second as DDT on distribution of such profits; and now third as dividend tax in the hands of shareholders receiving more than Rs. 10,00,000. While the assessees and types of incomes are different at each taxing event, the total impact is high – especially for promoters of private and closely held companies will be detrimental. (see para 3.6 for more details.)

The new provision will come in force from 1st April, 2017 i.e. will be applicable from F.Y. 2016-17. Many companies have decided to issue interim dividends before 31st March to spare shareholders from this additional tax burden.

The promoters who hold shares in business companies through their personal holding companies, will not be liable to tax as long as their personal holding companies do not declare dividend.

3.3 Non-residents are not liable to this tax. As discussed in para 3.2, there are three levels of tax. The non-resident will be liable to tax in his home country. This will be the 4th level of tax. While he will get credit for tax in his country, he will mostly not be entitled to credit for corporate tax and DDT paid by the Indian company. Hence the burden can be very high. It is fair that the non-resident is not taxed on dividends.

3.4 Impact on foreign dividends:

Presently, dividends declared by a foreign company in which an Indian company holds 26% or more are taxed at 15% as per Section 115BBD. Further, these dividends are allowed as a deduction from dividends paid by the Indian company if the foreign company is a subsidiary of the Indian company. This results in net tax of 15% on foreign dividends earned by Indian promoters. With the proposed levy of additional tax of 10% on dividends exceeding Rs. 10 lakhs, the effective tax will increase to 25%.

3.5 Businessmen prefer holding business through LLPs instead of companies. There is no tax on profits distributed by LLPs. Hence the dividend tax and now this additional tax will be a clear saving.

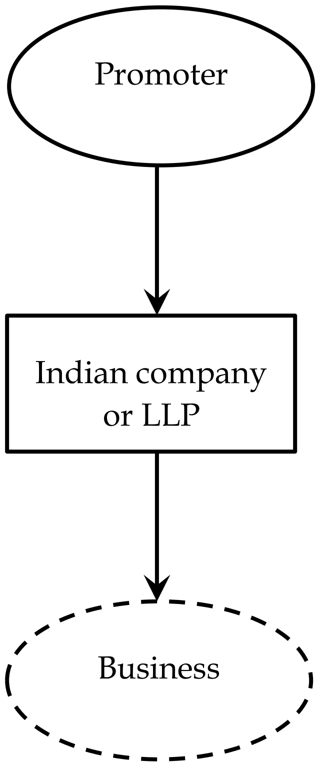
3.6 Different holding structures – through company, LLP, Indian companies and foreign companies gives rise to several permutations. One needs to carefully analyse under what structure should investments be held. Some illustrations are given below in paras 3.7 and 3.8.

3.7 Indian business held through Indian entities

- Indian Promoter does business in India.

- He can do business through a private company or a LLP.

- The holding structure is give below. The table after the chart gives tax implications.



Sr.	Particulars		Operating business entity	
			Indian company	**Indian LLP**
1	**Business profit and tax**			
1.1	Net profit		1,000	1,000
1.2	Tax on net profit	30%	<u>300</u>	<u>300</u>
1.3	Profit after tax		700	700
2	**Distribution of profit and tax**			
2.1	Dividend distributed by company. LLP distributed profits		500	500
2.2	DDT paid by Indian company	15%	150	0
2.3	Tax payable by shareholder / partner	10%	50	0
3	Total tax paid (1.2+2.2+2.3)		**500**	**300**

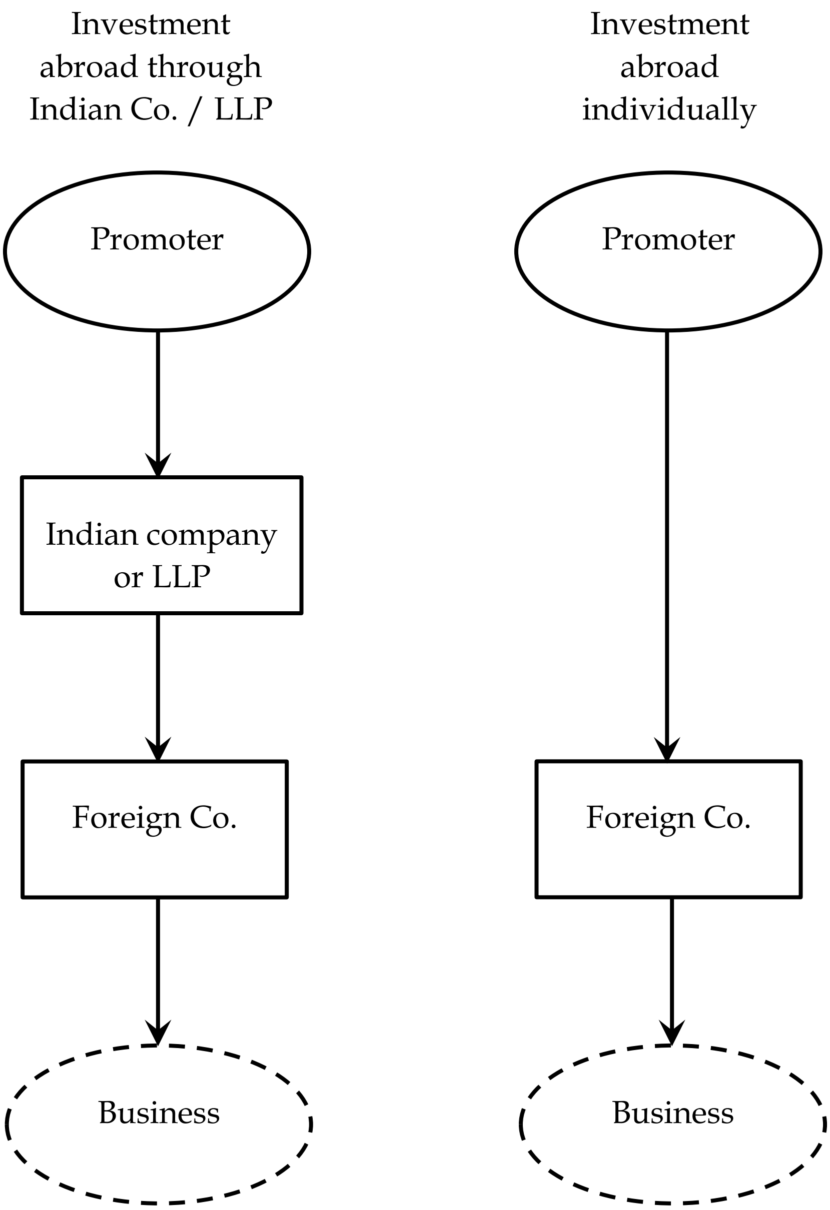
3.8 Foreign business held through Indian entities

- Indian promoter does business outside India.

- He opens a foreign company outside India.

- The shares of foreign company can be held by individual, Indian company or Indian LLP.

- The holding structures are given below. The table after the chart gives tax implications.



Sr.	Particulars		Foreign company held under various options		
			Through Indian company	Through Indian LLP	Individually
1	**Business profits and tax**				
1.1	Net profit		1,000	1,000	1,000
1.2	Foreign Tax on profit (assumed)	30%	300	300	300
1.3	Profit after tax		700	700	700
2	**Distribution of profit and tax**				
2.1	Dividend distributed by foreign company		500	500	500
2.2	Tax on dividend in foreign country – assumed *	10%	50	50	50
2.3	Tax payable by shareholder in India Tax rate for companies – 15% Tax rate for LLP / individual – 30%		75	150	150
2.4	Less: Tax credit for foreign tax on dividend (2.2 above)		50	50	50
2.5	Net tax paid in India (2.3 - 2.4)		25	100	100
3	Funds after tax on dividend - distributed to promoter (2.1-2.3)		425	350	350
4	Tax payable by promoter **		43	0	0
5	Total tax paid (1.2+2.2+4)		**418**	**450**	**450**

* Tax on dividend in the foreign country will normally be restricted by the DTA to 10 or 15%. It will be available as a credit against Indian tax. Hence the total in India and abroad will be 15%. If tax payable in the foreign country exceeds 15%, the total tax cost will increase.

** On declaring dividend by Indian company to the promoter, DDT is payable. However in the above illustration, dividend received from foreign company will be set off against dividend paid by the Indian company. Hence there will be no DDT payable. However there may be some controversy. Tax payable in India will be the net tax after reducing foreign tax. Hence when the Indian company declares dividend, will credit be available for the total tax paid (i.e. 2.3 above) or tax paid in India (i.e. 2.5 above).

3.9 It should be appreciated that thinking on taxes keep changing every few years. Hence if the cost of changing the structure is high, the structure may be left as it is.

The primary conclusion which one may draw is that in case of holding Indian business, an LLP can be considered.

For foreign businesses, an Indian company appears to be better. Although tax cost is lower if foreign company is held through an Indian company, the regulations for companies are quite onerous. An LLP has far lesser compliances. Hence an LLP can be a good option. One may balance the same and take a decision.

Chapter B. Equalisation Levy – E-commerce:

4. Background:

Finance Minister has proposed Equalisation Levy (EL) through Finance Bill, 2016, Chapter VIII.

E-commerce companies like Face Book, Google, etc. are earning substantial revenues and some of them are avoiding Income-tax in the Country of Source (COS) as well as Country of Residence (COR). E-commerce business is growing at the fastest rate globally and no Government in the world can allow this business to go tax free.

It is now admitted by OECD and other concerned authorities that under the present rules of international taxation, E-commerce companies can escape taxation. The main reason is that - under the existing rules, COS can tax a non-resident providing E-commerce services only if the non-resident has a permanent establishment (PE) in the COS. And a PE is defined as a fixed place of business. E-commerce companies do not need PE in any COS. They can set up the companies in tax havens and avoid COR tax also. For the last few years, there was strong public criticism – in Britain and other European countries - of these companies escaping taxation. In the light of the American and European financial crisis, G20 countries asked OECD to come out with recommendations for necessary modifications in the existing rules so that E-commerce companies also can be taxed.

BEPS Action Report No. 1 on Digital Commerce has discussed these issues. It has not made any specific recommendation. However, it has given three different options. One of the options is Equalisation Levy. When a company resident in COS earns revenue from E-commerce business, that company has to pay indirect taxes as well as Income-tax. However, when a non-resident company provides E-commerce services, it escapes Income-tax. Equalisation Levy tries to make a level playing field for both – Resident & Non-Resident.

In India, CBDT appointed “E-commerce Committee” to study the subject and to recommend appropriate law for taxing NR E-commerce entities. Committee has given its report & Finance Minister has made proposal for Equalisation Levy to tax E-Commerce companies.

Finance Act Proposals:

4.1 Only Non-Resident earners:

Equalisation Levy is proposed to be **charged only on non-residents** of India. Its very purpose is to protect Indian Residents. Hence Indian E-commerce companies like Flipkart, Snap Deal etc. are not liable to Equalisation Levy. If a company is non-resident today and it opens a subsidiary or a PE in India to provide E-commerce services in India; it will be liable to normal Indian Income-tax and it will escape Equalisation Levy.

4.2 Only Services:

Equalisation Levy is charged only for services. There is no such tax on goods sold through E-commerce. Simple reason is: Somehow, the rules of international taxation have distinguished goods and services. This weakness in the system continues at present. Finance Minister is not trying to remove a global weakness through his budget proposals. The impact is: Even after the budget is passed, if someone purchases goods on E-commerce platforms, he will not have to deduct EL at source.

4.3 No Characterisation, No PE:

EL is so designed that there is no characterisation issue. One does not have to determine whether it is a business income, royalty, or FTS or any other category of income. There is no need to determine Permanent Establishment or any other nexus to India. Simply because a non-resident earns **revenue from India** he is liable to Equalisation Levy.

4.4 Independent Tax: No DTA:

This is not Income-tax. Chapter VIII of Finance Bill does not become part of the Income-tax law. Like STT, it will remain a separate tax. Hence Double Tax avoidance Agreements are not applicable to EL.

4.5 Compliance:

4.5.1 Ideally, the responsibility to pay tax and file EL returns should be on the non-resident. However, enforcing these obligations on a non-resident requires a lot of ground work. Best method of ensuring compliance by Non-Residents who have no PE in India would be – to ask all banks, credit card companies and Payment Gateways to deduct EL before making the remittance abroad. However, at present, there is no mechanism under which EL can be deducted by credit card companies from payments made through credit cards. The E-Commerce Committee had a discussion with Reserve Bank of India. And RBI confirmed that at present, it will not be possible to impose TDS through credit cards. (Note: In this article, by the term "TDS" we mean Deduction of Equalisation Levy at Source.) In the circumstances, the only mechanism available to the Government of India was to recover the tax from the **Indian resident payer**.

This will mean: the burden of tax may fall on the Indian resident payer. The non-resident service provider may refuse to bear the cost of EL. There can be different situations. Large consumer goods companies - that advertise on media & net - have strong bargaining power. They can refuse to bear the cost. And any online company hosting the advertiement may have to bear the cost of EL for advertisements received from such strong companies. Very small payers – paying less than Rs. one lakh will not be liable to deduct EL. Payers falling between the two categories, may have to suffer the burden of EL. Even these persons may have choices in some cases. If there is competition, they will go to an alternative where the payer does not have to suffer the EL. Hence the force of market competition may make the NR receiver to bear the cost of EL.

It may be noted that the present proposal is a **work-in-progress**. A lot of work needs to be done. Government in collaboration with Reserve Bank of India may work out a mechanism whereby any payment from an Indian resident to a non-resident can be separated if it is an E-commerce payment. Once this step is implemented, EL can be deducted by credit card companies, banks and all payment gateways. Until this is done, a compromise has to be accepted. This is what the Finance Bill proposes. The onus of compliance is on Resident Payers.

Under the Finance Bill proposal Indian resident payers will deduct EL at source and pay to the Government of India. Whole mechanism for charging of tax, payment of tax, filing of returns and assessments – all can be completed on internet. The tax deductor may not have to meet Income-tax department.

4.5.2 Business:

Only persons carrying on business or profession and making payment for specified services to non-resident E-commerce companies are liable for deducting EL at source and paying to Government of India. The payment mechanism is simple. From all the payments to a non-resident, tax may be deducted throughout a month. It has to be **paid** to the Government of India on or before 7th day of next succeeding month - Section 163.

This responsibility to deduct EL is cast upon – (i) Indian resident business entity; as well as (ii) a Non-resident's permanent establishment in India – if it is carrying on business in India and makes payments for specified services.

A return of EL needs to be filed after the end of the year on or before a date to be prescribed by EL rules.

If the Indian resident assessee does not pay tax to the Government of India, he will be liable to tax, interest and penalty under Chapter VIII of the Finance Act. He will also be liable to disallowance of expenditure from his business income under Section 40 (a) (ib).

4.5.3 Non-resident – No compliance:

At present, the **non-resident has no responsibility under the law**. He does not have to file any tax return nor pay anything. If a resident payer does not deduct EL at source and does not pay to the Government of India, it does not mean that the non-resident receiver is then liable to pay the tax. This is also work-in-progress and needs to be improved.

4.6 Administration:

Equalisation Levy will be administered by the **Income-tax department.**

4.7 Scheme of the tax: Chapter VIII:

In a very small chapter all the provisions for charging of tax, scope of revenues liable to tax, collection machinery, assessment, penalty, prosecution and appeals – everything is provided. This chapter is an **independent & complete chapter by itself.**

4.7.1 Its connections with Income-tax Act are as under:

(i) Words not defined in this chapter will take their meanings from Income-tax Act.

(ii) If the Indian Resident does not deduct EL, the expenditure will not be available at a deduction under ITA Section 40 (a) (ib).

(iii) Once a payment is chargeable to EL, it will be exempted ITA Section 10(50).

(iv) Appeal & similar other provisions of ITA will apply to EL also. EL Section 175.

Except for these issues, the Income-tax Act concepts are not applicable to El.

4.7.2 Listing of Sections:

Section 160 provides for the jurisdiction comparable to Section 1 of Indian Income-tax Act (ITA).

Section 161 provides for definitions.

Section 162 provides for the charge of tax (Section 4 of ITA), Scope of tax (Section 5 of ITA), and the assessee [Section 2 (7) of ITA].

Section 163 provides for TDS.

Section 164 provides for filing of annual return.

Section 165 provides for assessment.

Other sections are for interest, penalty, prosecution & appeals.

4.8 Home Consumer is exempt:

Millions of home consumers and small business consumers utilise internet services like Google, Face Book, What’s App etc. Most of us do not make any payment to the service provider. Hence we are not liable to deduct any tax at source.

Assuming some home consumer makes payment for any specialised services, he will still not be liable to deduct any tax. This is specifically provided in the charging section – 162 (1) (i). This means that millions of consumers are not at all affected by EL.

Even for business payers, the TDS is applicable only if his payment for specified services to non-resident service provider exceeds Rs. 1,00,000 during a financial year. Section 162 (2) (b). Thus assessees making small payments are exempted from TDS compliance. One Non-Resident may receive – say Rs. 99,000 from ten Indian assesses. Still, he will not suffer any EL. Similarly, one resident may pay Rs. 99,000 to ten non-residents. He will not be liable to deduct EL. It may be noted that the NR E-commerce MNCs earn from Rs. 100 crores to Rs. 5,000 crores from India. For these target companies, the thresholds of Rs. 1,00,000 are so small that any manipulation by increasing the number of companies won't be worthwhile.

It may be noted that there are two way thresholds:

(i) If the **non-resident** service provider receives less than Rs. 1 lakh, he is not liable to EL – section 162 (2) (b).

(ii) If the **resident** payer is paying less than Rs. 1 lakh, he is not liable to deduct EL at source – Section 163 (1).

4.9 No Double Taxation within India:

Once a non-resident's income is chargeable to tax under chapter VIII of Finance Bill, 2016, it is exempted from Indian Income-tax under Section 10 (50). Thus, there will be no double taxation of the same income within India. It may be better for the non-resident to be covered under EL rather than under ITA.

4.10 No Grossing Up:

Under Indian Income-tax Act, Section 195 etc. provide for deduction of Income-tax at source from payments made to non-residents. There are cases when the non-resident insists that the tax should be borne by Indian resident. In such a situation, the Indian resident has to gross up the tax and suffer more. Section 195 A. For illustration, if the TDS rate is 10%, in this situation, Indian resident payer will have to suffer 11% tax.

Section 163 of Chapter VIII provides for deduction and payment of EL. Section 163 (3) provides that even if Indian resident payer does not deduct EL, he has to make payment of EL to Government of India. Thus, consider that the Indian resident has made a payment of Rs. 100 to the non-resident, he has not deducted any tax at source. He will simply pay Rs. 6 to the Government of India and close the chapter.

4.11 Tax Rate:

The rate of tax under EL is only 6%. This is much lower than the normal TDS rates of 10% to 15%. This is an attraction for the non-residents. Instead of suffering a higher rate of tax under Income-tax, they can bear the EL and pay lower tax. Further, there will be no further controversy about characterisation of payment, determination of PE etc. The whole scheme will be simple in administration by the department and compliance by the assessee.

The lower rate compensates for the fact that most assessees will not be able to claim **credit of EL** under the Double Tax Avoidance Agreements. They can of course claim the EL as an expenditure suffered by them but not the relief of full tax adjustments.

4.12 Specified Service:

Section 161 (h) defines specified service as – online advertisement, provision of digital advertising space etc. and includes **any other service as may be notified by the Government.**

It may be noted that E-commerce is a constantly developing business. There are so many technologies which together make it possible to do global business without PE in COS. Some of them can be listed as: computers, internet, television, mobile phones, satellites, cables, telephones; and a convergence of all these technologies. Each technology in the field of science keeps developing. Convergence of developing technologies provide a huge constantly changing mechanism for developing new businesses. Today traditional businesses conduct their business with new technologies. And completely new businesses are developing.

In this situation, defining anything as E-commerce would be incorrect. Today's definition in the law will require an amendment within a few years. Recognising this fact, OECD had earlier published its reports under the title – "E-commerce". Present BEPS action reports are calling the same business as "Digital Commerce". Sometime back E-commerce could be conducted only through computers. At that time, no one could imagine international business transacted through telephones. Today, international business through mobile phones has become a reality. It is eminently possible that in three years' time, there will be another way of doing international business which is not considered today.

Recognising these facts of modern life, the budget proposal defines the services as "Specified Service". This definition can always be expanded by the Government. Thus the law provides for flexibility in line with the kind of business proposed to be taxed.

On the whole, Finance Minister has made an efficient and simple proposal to tax giant MNC.

Note - CA Rashmin Sanghvi - was a member in both committees appointed by CBDT for E-commerce: the High Powered Committee of 1999-2000; and the E-commerce Committee of 2015-16.

More detailed article is uploaded on our website.

Chapter C. New Tax Exemptions:

5. Taxation of Income from Patents: [S. 115BBF]

5.1 For encouraging Research and Development in India, the finance minister has proposed to levy a low rate of tax on royalty from Indian patents. It is proposed to levy a **low tax @ 10 %** on the royalty income earned from patents developed in India.

For claiming this benefit, following conditions need to be satisfied:

i) The person should be an **Indian resident.**

ii) The person who developed the patent should be the **true and first inventor** of the invention.

iii) At least 75% of the expenditure should be incurred by the eligible person.

iii) The patents need to be **developed and registered in India.**

iv) **No expenditure** or **allowance** can be claimed against this income.

5.2 Indian companies are liable to Minimum Alternative Tax (MAT) which is 18.5% of Book profits. The income falling under this new provision will not be **considered** while calculating Minimum Alternative Tax (MAT). Thus tax will be restricted to 10%.

5.3 For availing the benefit of lower tax rate, the person should exercise this option before the due date of filing the return. If the option of lower tax rate is exercised for any year, and in any of the five subsequent years he does not offer income as per this provision, he will not be entitled to take benefit of this provision for next 5 years.

5.4 Patent Box regime – how is Indian tax system different:

Some people have been referring to this provision of low tax rate for patents as "Patent Box Regime". What is patent box is explained below.

Countries have been providing lower tax rate in case of royalty incomes. It started with Ireland providing tax relief to people who earn income out of patents. The patents were developed elsewhere. The expenditure was incurred elsewhere. However the patents were registered in Ireland and income was taxed a lower rate. Several other countries offer Patent Box regimes with variations.

These were known as “Patent Box Regimes”. The metaphor is that it is like a box where you drop (register) the patent. Once it is registered, low tax will apply. UK also started providing such relief in 2013. There were protests from other countries. OECD in its BEPS reports has said these patent box regimes should have “nexus-based” approach. The patents should be registered only if expenditure has been incurred in those countries and the patent holder has itself undertaken he activities. In essence, relief can be given by a Government only if development takes place in that country.

The Indian patent tax rate goes in line with the OECD suggestions. It provides relief to only the first and true developer of patent. Thus one cannot buy patent from someone else, register in India and earn income at a lower rate. This provision is intended only for encouragement of development and registration of patents in India by innovators.

5.5 Under the current law, section 80RRB provides a deduction up to Rs. 3,00,000 on income earned by way of royalty in respect of Patents registered in India. This small relief is for individuals. This provision also continues.

6. Start-ups - Tax incentives: [S. 80-IAC & S. 54GB]

6.1 To promote the Start-up India initiative of Prime Minister Narendra Modi, some tax incentives are proposed in the budget. These incentives are provided so as to facilitate a person who is in the initial stage of setting up its business. The incentives include tax relief for start-up business, and capital gains tax relief for persons investing in a start-up business.

The relief for start-up business is discussed below. Capital gain relief is discussed in para 6.2.

The details of Government’s plan for Start-ups are available on the website of DIPP at the following websites:

http://dipp.nic.in/English/Investor/startupindia.aspx.
http://startupindia.gov.in/

6.2 Tax incentive for Start-up business: [S. 80-IAC]

The finance bill proposes a deduction of 100 % profits of a start-up for a consecutive period of 3 years out of 5 years starting from the year in which the startup is incorporated.

The incentive is available to a company as well as Limited Liability Partnership (LLP). To avail the said benefit, following conditions need to be satisfied:

i) The company or LLP needs to be incorporated between 1st April, 2016 and 1st April, 2019.

ii) The annual turnover **should not exceed Rs. 25 Crore** during any of the financial years - 2016-17 to 2020-21.

iii) The company or LLP should be **in the eligible business** which involves "*innovation, development, deployment or commercialisation of new products, processes or services driven by technology or intellectual property*".

iv) The company or LLP should have a **certificate of eligible business** from the Inter-Ministerial Board of Certification.

6.3 Relief for business:

The relief is available for "eligible business". Thus a company or LLP may have other businesses. If it commences a start-up business, relief will be available for the start-up business if the specified conditions are fulfilled.

The business will need to have its accounts audited.

6.4 Period of relief:

Many start-ups make profits only after a few years. The Government has provided relief for 3 consecutive years out of first 5 years. The company or LLP can choose this 3 year period. Thus if it makes losses for first 2 years, it can choose to take this relief for the 3rd to the 5th year.

What will happen to the losses of the first 2 years? These will be carried forward for upto 8 years and set off against the profit of those years. Thus the first year loss can be set off against profits of 6th to 9th year.

What if the company or LLP has a loss during the period of 3 years? For example, it has a profit for 3rd and 5th year but a loss for 4th year. In this case, the loss of the 4th year can be carried forward. If it gets set off against the profit of 5th year, then there will be no relief for the profit of 5th year. If the loss cannot be fully set off against the profit for 5th year, it can be carried forward to subsequent years (upto 8 years).

In this manner, the start-up can claim relief for profits; and at the same time carry-forward its losses in other years.

6.5 Transactions with other businesses or related parties:

If there are any transactions with other business divisions ("other businesses"), or with other related parties, the transactions should be at market prices. This is to prevent people from claiming a higher relief than what should be available. An illustration is given below.

Illustration:

A software company develops a new app which helps people to monitor their health periodically and in a simple manner. This new app (health app) is approved by the Inter-Ministerial Board of Certification.

The health app business can sell subscription for its app to other divisions of the company, or to related companies. If it sells the subscription at a price which is higher than the market price, it can show a higher profit - on which it will not pay any tax. The other divisions / related companies will show lower profits as they will be claiming higher expenditure. To prevent such abuse, the provisions state that relief to health-app business will be available only to the extent of sale price being considered at market prices. Such anti-abuse measures are present in all provisions which provide for profit-based relief.

6.6 Normally for transactions with other businesses or related parties, transfer pricing rules apply. Thus audit, documentation, etc., apply. For start-up business, there is no requirement for transfer pricing audits, etc. It is a relief as application of detailed transfer pricing provisions can be an expensive exercise for start-ups.

It however should be borne in mind that the start-up will have to satisfy to the Income-tax officer that transactions with inter-company divisions or related parties are at market prices. Only detailed rules for audits, documents, etc. will not be applicable.

(It may be noted that there is no specific provision for providing relief. Section 92BA of the Income-tax Act provides that assessees claiming relief for businesses like infrastructure, etc. are required comply with Transfer Pricing rules. In section 92BA, start-ups businesses are not covered. Thus Transfer Pricing rules do not apply to start-ups.)

6.7 There are appropriate provisions to provide relief only to new businesses. Reorganisation of old businesses as new businesses will not be eligible.

6.8 While this is a welcome initiative and in line with the Government's focus on start-ups, there seem to be quite a few conditions to be met for a start-up to obtain the certificate to claim this relief. Implementation will be key to success of this provision.

7. Incentive for employment generation: [S. 80JJA]

7.1 To provide a tax incentive to employers, higher deduction of expenses is provided for salary payments to new employees. This incentive had many conditions and was not successful in increasing employment. The provision is now proposed to be revised as under.

7.2 Deduction available:

A deduction of 30% of salary cost of <u>new employees</u> will be available to the employer. This is over and above the deduction for regular salary expenditure.

At present the additional deduction is available if the number of employees in the current year are 10 % more than the previous year. This condition has now been relaxed. There has to be an **increase in the number of employees** compared to the number of employees at the previous year-end.

7.3 Employees covered:

The relief is available only towards salary payments for those employees:

whose salary does not exceed Rs. 25,000 per month;
to whom salary is paid by bank or electronic transfer; and
who participates in the recognized provident fund.

There are a few other conditions also which have to be complied with.

7.4 Eligible persons / businesses:

At present the relief is available **only to companies** engaged in **manufacturing of goods in a factory**. Keeping in mind the need to increase the employment in the country, the government has now **increased the scope of additional deduction to almost all businesses**.

Under the new proposal, the additional deduction will be applicable to **all sectors of employers who are liable for tax audit**. The employer can be a corporate as well as a non-corporate entity; can be a resident or a non-resident.

Thus for example, employers with a turnover of upto Rs. 2 cr. who earn profit of less than 8% of their turnover are covered under tax audit. These employers can also claim this benefit. (see para 19 for presumptive taxation.)

7.5 The minimum number of days that the employee needs to be employed for has been proposed to be reduced from **300 to 240 days**.

There are appropriate provisions to see that relief is not available to business formed by reorganisation of old business. For example: One can close an old business and start the same business in a new entity. All employees in the old business will be employed by the new entity. Such employers may claim that they have engaged new employees. This kind of planning is not permitted.

8. Deduction in respect of profits and gains from housing projects: [S. 80-IBA]

8.1 The Government of India has launched 'Housing for All by 2022' mission in the year 2015 that guarantees to provide affordable housing for all by 2022.

With a view to incentivise affordable housing, a new section has been proposed to provide a deduction of 100% of the profits and gains derived from business of developing and building housing projects.

8.2 The incentive is for small homes and small projects. The homes should not exceed 30 sq. meters built-up area (approx. 300 sq. feet) in Mumbai, Delhi, Kolkata, Chennai or within 25 kms measured aerially from the municipal limits of these cities. In other cities, it can be up to 60 sq. meters (approx. 600 sq. feet).

The project itself should be on a land area of 1,000 sq. meters or more in Mumbai, Delhi, Kolkata, Chennai or within 25 kms measured aerially from the municipal limits of these cities. In other cities, the land area should be of 2,000 sq. meters or more.

The project is the only housing project on the land referred to above.

8.3 The project should be approved by the relevant authorities between 1st June 2016 and 31st March 2019. The project should be completed within 3 years from the date of approval. If the project is not completed within 3 years, the relief claimed in the previous years will be considered as income in the year in which the due date of completion falls.

8.4 Appropriate checks have been kept to avoid misuse the provisions. For example, where a home is sold to an individual in a project, his spouse and minor children cannot be allotted another home in the same project.

In the past builders have combined smaller flats into one large flat and sold the same to HNIs. This time the definition has provided for the meaning of "residential unit". It has been defined as – "*an independent housing unit with separate facilities for living, cooking and sanitary requirements, distinctly separated from other residential units within the building, which is directly accessible from an outer door or through an interior door in a shared hallway and not by walking through the living space of another household*".

Thus it may be difficult to combine 2 or more units as one, and then sell it to people.

Still can there be any planning? Well time will say.

There are apprehensions that this relief will not reduce prices of houses for people with lower income.

Chapter D. Foreign Companies & Non-Residents:

9. Place of Effective Management: [S. 6(3) & S. 115JH]

9.1 POEM provisions deferred to 1st April 2016:

Companies are held to be Indian resident if they are incorporated in India or if they are wholly controlled and managed from India.

The Government had amended the rule determining residence of companies last year whereby companies which are effectively managed from India would be held as resident in India.

The Explanatory Memorandum to Budget 2015 provided that the change was brought in mainly to bring in to the tax net shell companies which were incorporated by Indian residents outside India. Such companies were effectively managed from India. However, the earlier provision allowed such companies to remain non-resident by making sure that just a part of its management lies outside India. Our detailed note on the provision form part of our last year's Budget Notes and is available here - http://rashminsanghvi.com/downloads/taxation/international-taxation/place_of_effective_management(poem).htm.

The Explanatory Memorandum further mentioned that the Income-tax Department will come out with **Guidelines** on determining where a company's place of effective management is situated. However, these guidelines have still not been finalised. Draft Guidelines were issued in December 2015. Several representations have been made on the same. However, the final guidelines have still not been issued. Meanwhile, the POEM provision had become effective from 1st April 2015 itself.

As there was general lack of clarity, representation was made for deferring this provision.

The Budget now proposes that the POEM rules will become effective from 1st April 2016 instead of 1st April 2015. However, it must be noted that the final guidelines have still not been issued by the Department. We hope that these guidelines will be finalised by the time the President approves the Finance Bill.

Thus upto FY 2015-16, the residence of a foreign company will considered to be in India, if control and management is "wholly" in India.

9.2 Transition provisions:

There are several implications on a foreign company being held to be an Indian resident due to POEM provisions. If a foreign company is considered tax resident of India, it needs to submit its world-wide income to tax in India; pay advance tax by the prescribed deadlines; and file its tax return in India. Apart from these immediate implications, the company would need to comply with TDS obligations; Transfer Pricing provisions; and have issues under Foreign tax credit. In fact, once a foreign company is held to be tax resident in India; and if it does not pay tax in India; **Black Money Act** will also be applicable.

Income-tax department of the host country (where the company is incorporated) will also treat the company as resident there. Thus these companies will have the problems of Dual Residence.

As POEM test is a subjective, there can be instances where a foreign company is held to be resident in India only on conclusion of assessment proceedings. If it is so held during assessment proceedings, it would be impossible for the foreign company to comply with any of the Indian tax provisions as the deadlines would have been crossed. Further, in most cases, facts remaining the same, the company can be held to be Indian resident for the following tax years too.

Therefore, the Finance Bill has proposed a new section 115JH to provide for transition mechanism in such cases. It is proposed that the Government would issue a notification providing exemption or modification to such companies with regard to computation of income; treatment of unabsorbed depreciation; set off or carry forward of losses; collection and recovery of taxes and transfer pricing provisions. The notification would also provide certain conditions which need to be fulfilled by such company before it can avail of these relaxations. Further, if such conditions are not met by a company subsequently, the exemptions and modifications would be reversed and the tax officer would have the power to recompute the income chargeable to tax.

These provisions will apply to those foreign companies which become Indian residents for the first time. Thus the provisions will apply to the "first year" in which it becomes an Indian resident. Further if the foreign company is held to be an Indian resident <u>during an assessment</u>, the provisions will also apply to the years subsequent to the "first year" - till the previous year ending before the date of assessment. For example, the foreign company is considered as Indian resident for the first time for FY 2016-17. This happens during an assessment which happens in January 2020. These relief provisions will apply for FY 2016-17 (first year); and subsequent financial years 2017-18 and 2018-19. It would have been better to extend this relief for FY 2019-20 the company would come to know its position in January 2020 only.

In our view, the Government has well considered various representations on this matter and these transition provisions should bring in required flexibility for assessees to whom POEM provisions are applied. However, we need to wait for the proposed notification to check which implications are finally covered; and what conditions are cited by the Government for availing such relaxations.

A safe course of action may be: where the Company considers itself to be Indian Resident under PEOM, it should comply with the law, file Indian tax returns and pay tax. Do not wait until Income-tax officer asks you.

10. MAT on Foreign Companies: [S. 115JB]

In case of companies, there is a minimum alternative tax (MAT). If the normal income tax is less than 18.5% of book profits, then a minimum of 18.5% of book profits has to be paid as MAT.

There has been a controversy on whether these provisions are applicable to a foreign company or not. The issue was revived on account of certain contradictory judgements by the Authority for Advance Rulings (AAR). By way of Finance Act 2015, it was provided that incomes earned by a foreign company in the nature of capital gains, interest, royalty and fees for technical services would be allowed as a deduction from book profits if the tax rate is lower than the rate as per MAT provisions. This brought in relief for Foreign Institutional Investors (FIIs)/Foreign Portfolio Investors (FPIs) from MAT provisions.

However, this amendment was brought in prospectively and hence would be applicable only from 1st April 2015. Taking support of such prospective amendment, tax authorities started issuing notices on FIIs and FPIs for payment under MAT provisions for earlier years.

Therefore the Government set up a **committee** under the Chairmanship of **Justice A P Shah** to provide recommendations for FIIs/FPIs. The committee recommended that it should be clarified that these provisions were not applicable to FIIs and FPIs since inception. The Government accepted this recommendation and issued a press release accordingly.

However, the matter was still not resolved for other foreign companies. The Government then issued a further press release on 24th

September 2015 stating that section 115JB shall not be applicable to a foreign company if —

- the foreign company is a resident of a country having DTAA with India and such foreign company does not have a permanent establishment in India; or

- the foreign company is a resident of a country which does not have a DTAA with India and such foreign company is not required to seek registration under section 592 of the Companies Act 1956 or section 380 of the Companies Act 2013.

It also clarified that appropriate amendment will be brought in the Income-tax Act. The Finance Bill 2016 hence proposes an Explanation to be added to the MAT provisions to bring the above clarification as part of law with retrospective effect from AY 2001-02.

It is good to note that while the Government has promised not to pass any retrospective taxing provisions it has provided a retrospective relief even though the matter was controversial.

Thus in essence now MAT will apply to foreign companies which have a place of business in India and earn taxable income in India. Due to place of business in India, foreign companies have to register themselves with Registrar of Companies. They have to file annual accounts with ROC. These companies will be liable to maintain accounts from which book profit can be computed. They will be liable to pay MAT.

11. Relaxation on citing PAN for payments to Non-residents: [S. 206AA]

Section 206AA of the Act mandates a person receiving any income to furnish his Permanent Account Number (PAN) to the payer. If PAN is not furnished, the payer needs to deduct tax at source at applicable tax rates or at a rate of 20 per cent, whichever is higher.

While the provision is applicable for all payments on which tax is deductible at source; it became especially cumbersome for payments to non-residents as most non-residents would not possess a PAN. Further even if there is a DTA between the countries of payer and payee, tax rate had to be deducted at a rate higher than the DTA rate. In some cases, the residents had to bear the higher tax if they did not have the bargaining power.

Some payers litigated the matter. They argued that if the tax rate as per DTA is lower than 20%, then whether PAN is available or not, the DTA rate should apply. Some decisions were in favour of the tax payer.

The Finance Bill now proposes that these provisions will not be applicable to a non-resident if specified conditions are met. Thus even if the non-resident does not have a PAN, section 206AA will not apply. Tax will have to be deducted as per the DTA rate. This is a much required relaxation in law and will ease cross-border transactions. However, the conditions are yet to be prescribed by the Government and may form part of amendments in Income-tax Rules.

Chapter E. Transfer Pricing:

12. Revised Transfer Pricing Documentation for MNEs: [S. 286]

12.1 Transfer Pricing (TP) provisions have been enshrined in the laws of major economies around the world for many years now. While the provisions have led to huge additions to taxable profits in many countries around the globe including India, the provisions have been dealt with by each country separately on a stand-alone basis.

12.2 Presently, MNEs have a chance to report different facts to tax authorities of different countries; or are required to share only specific details as required by that country's tax law. This enables leakage of tax revenue.

As part of the Base Erosion and Profit Shifting (BEPS) Project of the G20, OECD was mandated to come out with recommendations for Action Plan on Transfer Pricing Documentation. The aim is to create a **uniform standardised approach** to Transfer Pricing documentation enabling countries to share the data submitted by global Multinational Enterprises (MNEs). OECD has issued its Final Report as part of its Action Plan 13 on "Guidance on Transfer Pricing Documentation and Country-by-Country Reporting". The report recommends providing and maintaining documentation in a three-tiered format:

(i) a Master File containing standardised information relevant for all MNE group members;

(ii) a Local File referring specifically to material transactions of the local taxpayer; and

(iii) a Country-by-Country (CbC) report containing certain information relating to the global allocation of the MNE's income and taxes paid together with certain indicators of the location of economic activity within the MNE group.

12.3 India has taken an active part in the BEPS project; and as recommended in BEPS Report, India has introduced the revised documentation requirements.

The rules for local file containing details about transactions are already existing under the current Indian rules. The data for Master file is also provided under the current rules. The new provisions have enabled the tax department to specify what further data has to be maintained and to whom it will have to be furnished. This will be done by rules. As per the BEPS report, this Master file will have to be provided to each country where the MNE operates. This will be high level information about their global business and their Transfer Pricing policies.

The Country-by-Country report is the major change which the Finance Bill has proposed. This report has to be provided by the Holding Company in the group (usually the parent company) to the Government where that holding company is resident. Other governments will be able to access that information by requesting that Government. This is a major change in the documentation for Transfer Pricing.

All three reports combined will provide a tax officer the basic information to assess the areas where there may be Transfer Pricing issues. He will be able to take in to consideration the global structure of the MNE and the value addition made by it in India.

12.4 The **Country-by-Country report** has to be filed by the parent entity of the MNE group. The parent company can assign this responsibility to an alternative entity in the group. There is an apprehension that every company in India of a MNE group will have to file a CbC report. However that is not correct. There are two scenarios – i) where the parent company is an Indian resident (thus it is an Indian MNE like Tata group); and ii) where the parent company is resident outside India (thus it is a foreign MNE like Hindustan Unilever UK). These are discussed below.

12.5 **Indian MNE -** Primarily the CbC report has to be filed by the parent company where it is resident. Thus in case of Indian MNE, the parent company will be an Indian resident. Hence the parent company will have to file the CbC report with the return of income.

12.6 **Foreign MNE -** If the Indian company is group company of the foreign MNE whose parent company is outside India, it is that foreign parent company which will have to file the CbC with its tax department. In this situation, the Indian group company will internally have to provide the details to its foreign parent. However there is no statutory responsibility on the Indian companies.

However in the following situations, the Indian companies of foreign MNE group will have to file the CbC:

- If the parent company is in the country with which India does not have an agreement for exchange of information.

- If there is a systemic failure by the country with which India has an agreement for exchange of information, to provide the information required by India. In such a case India will notify the Indian entity to provide such information.

The Indian companies which are under the foreign parent company will have to file the details of the parent company and the country of which it is a resident. This will enable the Indian tax department to call for the information from the foreign Government.

12.7 The CbC report will require the entities to provide following information:

- revenue, profit & loss before Income-tax,
- amount of Income-tax paid and accrued,
- details of capital, accumulated earnings,
- number of employees,
- tangible assets other than cash or cash equivalent.

The above details will be required in respect of each country or territory along with details of each entity's residential status, nature and detail of main business activity and any other information as may be prescribed. This shall be based on the template provided in the OECD BEPS report on Action Plan 13.

12.8 As the CbC reporting requirements are quite robust and time consuming, the BEPS Report has presently provided for a **threshold of Euro 750 Million**. Therefore, the CbC reporting will not be required unless the consolidated revenue of the MNE group for the preceding year does not exceed Euro 750 Million. The Memorandum to the Finance Bill provides that this limit will be expressed in Indian currency at the exchange rate as on the last day of FY 2015-16. At current rates, this threshold works out to around Rs. 5,656.50 crores.

However, it must be noted that reporting requirements in respect of Master File and Local File are not subject to this threshold.

The specific formats in which all the three reports need to be submitted will be also be prescribed under the Income-tax Rules.

Chapter F. Black Money Declaration Scheme:

13. Black Money Disclosure Scheme:

13.1 Untaxed money is known by different names – Black money, unaccounted income, unexplained incomes, etc. The phrase used more often is "Black Money". Black Money is prevalent in India and many countries with varying degrees. India is not an exception. This needs to be tackled and therefore the Government has been trying to do this through various measures.

The Government has been taking various steps to reduce Black money. These steps include collection of information globally, enacting specific laws to tackle foreign black money, providing incentive to voluntarily disclose untaxed incomes, making PAN mandatory for many transactions, etc.

A list of some of the important measures taken by the Government are as under:

i) **Transfer Pricing** – to prevent Indian incomes being transferred to group companies outside India by over-pricing / under-pricing.

ii) **Black Money law** – to penalise persons who have untaxed income earned abroad.

iii) **Prevention of Money Laundering Act (PMLA)** – to confiscate property which is represented as clean property but is obtained by undertaking specified crimes like drug trafficking, corruption, etc. Exchange of information on Suspicious Transactions has already started – from the year 2003.

iv) **Benami Transactions (Prohibitions) Act** – to confiscate property which is held in someone else's name (benamidar or name lender) but actually belongs to the person who has paid for the same.

v) **General Anti-Avoidance Rules (GAAR)** – if the purpose of transaction is different than what is sought to be projected, the projected transaction can be ignored. Tax can be charged on the real purpose of the transaction. "Substance" will be given more importance than "form".

vi) Signing **Tax Exchange Information** Agreements with various countries.

vii) Actively contributing to **Base Erosion and Profit Sharing** measures at OECD / G20 forums. Under these steps, international tax rules would be modified to tax income where it actually accrues.

Each measure has a different purpose. We need to consider various measures in totality. With so many laws, it becomes very difficult to hide income and avoid taxes.

The Government has announced "**Income Declaration Scheme**" in the Finance Bill 2016. While the scheme is to give one opportunity to the people to declare their untaxed income and pay up taxes, there are other implications as well.

13.2 Tax evasion / avoidance:

It has been argued by the professionals in the past that "tax avoidance" is legal and "tax evasion" is illegal. "Tax avoidance" means use of legal rules (read legal loopholes) to minimise the taxes. It is use of "form" over "substance". The Governments across the world have come to conclusion and have taken steps to remove the difference between tax avoidance and tax evasion.

For Tax avoidance there are now "substance over form" rules, Anti-Avoidance provisions, Transfer pricing rules, etc. The Income Declaration Scheme is not meant for matters which can be dealt with by these rules. It is for plain tax evasion.

An illustration should help to clarify.

A person files a tax return disclosing capital gain of Rs. 10,00,000. This is earned out of sale of house property. During the course of sale, he had taken sale proceeds in cash. Or he had taken sale proceeds in the name of his family members - but as consultancy fee / salary etc. The family members have incomes below taxable limits. Thus no tax has been paid on such incomes. This is clearly tax evasion.

A person sells his property and earns capital gain. He invests the sale proceeds in construction of property within 3 years and saves capital gain tax. Assume that the person has no other taxable income and therefore does not file the tax return. While the income has not been disclosed to the tax department, there is no tax which has been avoided. Can this be considered as tax evasion? No. It is clearly not tax evasion. However see para 13.9 below.

13.3 Past declaration schemes:

In the past, Indian Government has come out with schemes offering immunities from penalty and prosecution for encouraging people to pay tax on past untaxed income. The last scheme was the scheme under Black Money Law in 2015. That was foreign incomes of Indian residents. Before that there was a Voluntary Disclosure Scheme in 1997 for all incomes – Indian and foreign.

There is a view that every Disclosure scheme is unfair to the people who have been paying taxes honestly. The income declaration schemes favour those who have avoided taxes in the past. As per some reports, in 1997, Government had given a declaration to the Supreme Court that it will not come out with any such scheme in future.

However in the interview by Mr. Hasmukh Adhia, financial services secretary published in Economic Times dated 2nd March 2016, it has been clarified that Government has not given any such assurances and Supreme Court also has not told the Government that it cannot come out with such schemes.

In any case, this scheme does not offer complete relief. There is immunity from prosecution. However the tax is payable on current market value of assets in the possession of the person. There will also be penalty payable. Care has been taken to avoid all the tax avoidance loopholes in the present scheme.

13.4 Key features of IDS:

13.4.1 It will be applicable to untaxed Indian income **earned upto 31st March 2016**. It offers people an opportunity to declare their untaxed income and pay a total of **45% of the untaxed income or assets** including surcharge and penalty.

13.4.2 It is proposed to make the scheme effective from 1st June 2016. It will be open upto a date to be notified by the Government.

13.4.3 The IDS applies only to Indian incomes (see paragraph 13.5(vi) below).

13.4.4 The IDS applies to residents and non-residents.

13.4.5 It applies to incomes on which tax was payable and has not been paid. "Undisclosed income" has been defined in Section 180(1) of the Finance Bill.

It should be noted, that there may have been a scrutiny assessment for any year. In that assessment, the income may not have been detected. Such income will also be considered as undisclosed. Thus as long as income has not been taxed – whether scrutiny assessment has taken place or not – it will be considered as "Undisclosed income".

13.4.6 The declaration will not be used for further proceedings against the person under the Income-tax and Wealth-tax Act. There is immunity under these laws. There is further relief under the Benami Act (see para 13.6 below). There is no relief / immunity under any other law.

13.5 IDS not available under these circumstances:

Under following circumstances the IDS is not available:

i) where under the Income tax Act a notice has been issued of scrutiny, or re-opening of assessment, or where raid / survey has been conducted and the assessment is pending.

ii) where any information has been received from a foreign Government under an agreement signed with the foreign government.

iii) to any person in respect of whom an order of detention has been made under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 (COFEPOSA) (subject to some conditions).

iv) in relation to prosecution for certain offences punishable under Indian Penal Code, the Narcotic Drugs and Psychotropic Substances Act, 1985, the Unlawful Activities (Prevention) Act, 1967 and the Prevention of Corruption Act, 1988.

v) to any person notified under section 3 of the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992 (Harshad Mehta scam).

vi) in relation to any undisclosed foreign income and asset which is chargeable to tax under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (i.e. untaxed foreign income of Indian resident). **Thus IDS applies only to Indian incomes**.

13.6 Benami Transactions (Prohibitions) Act 1988:

The Benami Transactions (Prohibitions) Act 1988 (Benami Act) was enacted in 1988. However it was never implemented. Subsequently in May 2015, some amendments have been made in the act. The amendments have been placed in the Lok Sabha. These have yet to be passed.

The purpose of Benami Act is as follows.

One of the ways of holding income (and assets out of the income) which a person does not want to be disclosed, is to hold the same in some other person's name. Thus if a person has earned income by way of bribe, he will hold it in some other person's name. Such other person is known as "benamidar" or name lender. The property will be enjoyed by the bribe earner (beneficial owner of property) but will be held in name of benamidar.

The Act provides that such property can be confiscated by the Government. There are penal consequences as well. (There are of course some exceptions for holding the property in relatives' names for bonafide purposes.)

It should be noted that Benami Act is not just for untaxed income. It is actually for corruption and other kinds of offences where the person earns income but cannot hold the property in his or her name. They then hold the property in someone else's name.

The IDS provides that if a declaration is filed under the IDS, the Benami Act will not apply to such income if the following conditions are satisfied:

- the asset declared under the IDS is transferred from the *benamidar* to the declarant who would have paid the consideration for such asset;

- the asset is transferred within the period notified by the Central Government.

Thus after declaring the income and paying the tax under IDS, the property should be transferred to the true owner. Otherwise under the Benami Act, the property remains liable for confiscation.

13.7 Asset and Valuation rules:

The untaxed income would most likely be in the form of assets. The current value of the assets will be considered for the purpose of taxation under IDS. The valuation rules are yet to be notified. Once these rules are notified we will have more details.

It has been proposed in S. 49 that if the asset has been disclosed under the Income Declaration Scheme, 2016 and tax has been paid on its fair market value, then the fair market value will be considered as the cost of asset for considering capital gains on transfer of such asset at a future date.

13.8 Time barring period under section 149 - Implications of not filing the declaration under this scheme:

13.8.1 Under Section 149 of the Income-tax act, there is a time barring period beyond which the tax department cannot issue a notice. Hence if income is not offered by the person and it is not detected within the prescribed time, there is nothing which the department can do.

Currently the time limit is 8 years from the beginning of the financial year for Indian incomes. Thus incomes earned before 1.4.2008, cannot be taxed if these are not detected before 31.3.2016. For foreign incomes, the time limit is 18 years from the beginning of the financial year.

13.8.2 There is no change in these time-barring periods under the Income tax Act. However under the Black Money law, for **foreign incomes** of Indian residents, the time limit has been removed. Thus income of any year – going back even upto 50 years – if it comes to the knowledge of the tax department, will be taxable under the Black Money law.

13.8.3 Now under the IDS also, it seems that the time limit has been removed. Under Section 194(c) of the Finance Bill 2016, it is provided that if no declaration is filed for any past income, then the income shall be considered to be of that year, in which the notice for scrutiny assessment etc. has been issued.

Say an income is earned in the year 2000. If it comes to the knowledge of tax department and it issues a notice in 2016, it will be considered as income of 2016. Technically the time barring of 8 years remain, however by treating the untaxed income and the **income of the year in which the notice is issued (i.e. 2016)**, the time barring period is effectively overridden.

It is not necessary that a notice should be issued for the year 2000. Legally the notice cannot be issued for the year 2000 as it is beyond the period of 8 years. The notice may be issued for 2016, but during the course of assessment for 2016, income of Year 2000 comes to light. Such income will be considered as income of 2016 and tax will be levied accordingly.

13.8.4 The relief under IDS by filing a declaration is available for incomes earned upto 31.3.2016. For incomes earned after 31.3.2016, the IDS does not apply.

This leads to a situation where for incomes earned after 31.3.2016, the time-barring period of 8 years is available! Whereas for incomes earned upto 31.3.2016, the time-barring period is not available.

13.8.5 There can be legal challenges to this view. For example, IDS is a scheme for providing relief. A scheme cannot override the law, and make income taxable which is otherwise not taxable. The Government has full rights to roll back any provision, remove time barring period etc. However there should be a proper law for that.

A counter view is that the IDS will be a part of Finance Act 2016. It is a statutory law. It will remain as a statute even after the time for the scheme is over.

This is a controversial matter.

Fair interpretation would be : S. 194(c) extends the period where the assessee himself wants to declare income beyond time barring period. For some reasons, the assessee may want it. However income-tax officer cannot serve notice for a period beyond time barring period.

13.8.6 **Implication of considering the income of the year in which notice is issued** - As the income will be considered as income of the year in which the notice is issued, there cannot be any **interest** for the past.

However **penalty proceedings** may be initiated as income will be considered to have escaped assessment. It came to light only when the tax department found out.

13.9 Some other illustrations and issues:

13.9.1 Kindly refer to the illustration in para 13.2. A person has legally saved tax on capital gain. However due to difference in the views of the tax department and tax payer, can income be considered to have been avoided? Can it be considered as income of the year in which it comes to light?

Will such capital gain be considered as income, or will the value of property acquired out of the capital gain be considered as income?

13.9.2 A person has acquired property due to inheritance. Such property cannot be considered as untaxed income. The person of course needs to establish that it is out of inheritance.

13.9.3 A person has high value property acquired out of incomes earned several years ago. The person may have destroyed the records as he is not required to keep the records for so many years. How can he establish that the property was acquired out of disclosed incomes?

For such situations, a person's tax return / balance sheet for those years will help. Going by past experience, one does not expect the tax department to go on fishing expedition. Only if the department gets specific records which show that tax has not been paid on past incomes, it may initiate proceedings.

13.9.4 A person has not paid any tax on income earned in 2000. After 2008 (completion of time-barring period), the person may have disclosed the income / assets in his returns. Can the department consider such income as current year's income by issuing a notice?

13.9.5 The IDS is available to all residents. However there is no immunity under the Companies Act. The Black money Act had provided immunity under the Companies Act also.

Hence untaxed income of companies may get immunity under the Income-tax and Wealth-tax laws, but not under Company Law.

13.9.6 In the interest of clarity and to avoid anxiety, the Government may come out with circulars clarifying the doubts of people.

Chapter G. Taxation – Removal of ambiguity for some transactions:

14. Tax on distributed income on buyback: [S. 115QA]

14.1 When an unlisted company buy-backs it own shares, it is required to pay tax of 20 % on the amount of distributed income (Section 115QA). Tax is payable on the difference between buy back price and the price at which the shares were issued. The shareholder is not liable to tax on Capital Gain earned under buy back. This provision is applicable to companies who buy back shares in accordance with Section 77A of the Companies Act, 1956 – i.e. where the company buys back shares from its own shareholders.

14.2 There have been cases where buyback arrangements were made as part of reorganisation under Section 391 of the Companies Act, 1956. Companies Act, 2013 has now been enacted in place of Companies Act, 1956. However the Income-tax Act still refers to Companies Act 1956. Tax payers took a view that if buy back is undertaken under Companies Act 2013, the company does not have to pay tax. The shareholder is liable to tax on Capital Gain. If the shareholder is in Mauritius, due to DTA, there is no Capital Gains tax.

Further buy back could happen in tranches and at different prices. Buy back could take place in a scheme of merger where instead of the amalgamating company, the amalgamated company bought back the shares. This gave opportunity of reducing taxes.

14.3 To resolve these issues, the government has come out with an amendment. Now, all arrangements for buy-back of shares under any law for the time being in force for companies are covered.

14.4 Further, there was no clarity on computation of issue price in cases of mergers and demergers. The finance bill therefore proposes to amend the definition of "distributed income". Rules for calculating the issue price will be separately prescribed for all situations.

The amendments will come in force from 1st June, 2016.

15. Capital Gain:

15.1 Capital Gain on Unlisted Shares: [S. 112 (1)(c)(iii)]

Under the current provisions of the Income Tax Act, Long Term Capital Gain (LTCG) on transfer of unlisted securities by non-residents (not being a company) is taxed at the rate of 10% (instead of 20% for other assets). The definition of "securities" [2] states that such securities should be marketable. Some Courts had taken a view that private company shares are not marketable, and hence not covered under the definition of "securities". Therefore the lower rate of 10% will not be applicable. The tax will be 20%.

The finance bill has clarified that shares of a company not being a company in which public are substantially interested (i.e. private company or public company with very few shareholders) will be eligible for tax rate of 10%.

15.2 Capital Gains Relief: [S. 54GB]

The current provisions provide for relief to individuals and HUF in case of Long Term capital gain on sale of house property if the gain is invested in small and medium sized business.

This budget extends the relief to investment in start-up business. If an individual or an HUF sells a house or a plot of land and uses the sale proceeds to invest in shares of a company which undertakes start-up business, there will be no tax on such capital gain.

Following conditions have to be satisfied to avail of the relief:

a. The whole of the proceeds are invested in a new company by subscribing to its equity shares.

b. The company should be a start-up company.

c. The company should be incorporated before the due date of filing the return of income.

d. The company should purchase new assets within one year from the subscription of the shares by the individual / HUF. New assets for "small and medium sized companies" mean plant and machinery.

   "Computers and software" are not considered as eligible assets for small and medium sized businesses. However for start-ups, assets include "computers and software". Thus the company can invest in computers and software. For a start-up, computers and software will be the main assets.

e. If all of the funds received on subscription are not utilised by the company for purchase of the new assets within the due date of

[2] Which is as per the Securities Contracts (Regulation) Act

filing the return, the balance funds need to be invested in a Capital Gain Account with a bank.

f. The person selling the residential property should have at least 50 % voting rights in the company.

16. Taxation of Gold Schemes: [S. 47(viic) & S. 49]

India is the largest importer of gold in the world and the imports form a large chunk of foreign exchange outgo for India. To temper the imports, various Governments have introduced different schemes or duties. The present Government has introduced two schemes –

- The Sovereign Gold Bond Scheme is aimed at replacing new investment in physical gold with Government backed gold bonds.

- The Gold Monetization Scheme is for conversion of physical gold held by Indians in to marketable certificates.

Both these schemes have not been successful as tax is payable on redemption of the bonds and certificates. To make these Schemes attractive the Government has proposed the following:

(a) Any redemption of **Sovereign Gold Bonds** by an individual would not be chargeable to tax as capital gains. Further, indexation benefit will be available for long-term capital gains earned on transfer by all assessees. The proposal will be effective from AY 2017-18, i.e., incomes earned from 1st April 2016 onwards.

(b) **Gold Deposit Certificates** will be exempt from capital gains; and interest earned thereon will also be exempt from tax. This relaxation is proposed to be brought in retrospectively from 1st April 2016 and hence will apply from AY 2016-17 onwards.

As a corollary, as capital gains will be exempt from tax, even losses incurred on fall in value of the bonds/certificates will not be available as a set-off against other gains.

It should be noted that only capital gains earned on redemption or transfer are exempt. If the Bonds or Certificates are held as stock-in-trade, the resulting profits may be taxable as business income.

While these proposals should attract further investment in these schemes, only the future will tell if Indians will move away from physical gold in favour of Government promises in the form of bonds or certificates.

17. Non – Compete Fees: [S. 28(va)]

17.1 In business, partners / collaborators part ways for various reasons. The partners who want to continue the business may pay an amount to the leaving partner for not carrying out similar activities as continuing partners. It helps continuing partners to do the business smoothly. Such amounts paid by continuing partners are referred to as "Non-compete" fees. Such amounts can also be paid for keeping confidential any know-how, patent, copyright, trademark, etc. by the leaving partners.

Non-compete fees are "Capital receipts" and not liable to tax. A few years ago, the law was amended. Therefore now under the current law, non-compete fees are taxable.

There is however a disparity in taxability of non-compete fees. Non-compete fees received for not carrying out **business activity** is taxable as business income. Non-compete fees paid in relation to **professional services** are not covered.

To bring parity between both types of incomes, non-compete fees received for not rendering professional services will also be taxable under the head "Income from Business and Profession".

17.2 Transactions can be undertaken in various manners. Instead of having an arrangement of non-compete fees, one can have an arrangement where the leaving partner can "sell" his "right to do business". The "right" is a capital asset. In such a case, the sale of such a right is Capital Gain.

It is clarified that non-compete fees in case of professional services which amount to Capital Gain, will be taxable as Capital Gain. Cost in case of such gain will be considered as NIL. This proviso is similar to that for business.

Whether the transaction is for payment of no-compete fees or sale of rights, depends on facts of the case.

Chapter H. Conversion of Company into LLP:

18. Additional conditions for availing tax exemption for conversion of a company into a LLP: [S. 47 (xiiib) (ea)]

To encourage conversion of companies in to LLPs, the Income-tax Act provides for an exemption from capital gains earned on such conversion. Businessmen would also like to convert a company into LLP to save on Dividend Distribution Tax. (Profits distributed by a company is liable to DDT @ 15% plus surcharge and education cess. Distribution by an LLP to its partners is not liable to any tax.) Apart from this, the Companies Act 2013 is very stringent. To come out of the rigors of Companies Act 2013, businessmen prefer an LLP.

One of the conditions presently applicable is that the total sales **turnover** or gross receipts in any of the 3 preceding years should not exceed **Rs. 60 lakhs**. The relief is for smaller companies.

Consider a case of private company holding huge reserves. It can stop its business, reduce its turnover and then convert itself into an LLP. Then it can distribute profits. There will be no tax. If it had distributed its profits while it was a company, it would have paid DDT.

Now an additional condition has been proposed. It states that this exemption will be available to companies which have **total assets** of upto **Rs. 5 crores** at the end of all three previous years preceding the one in which conversion takes place.

The Government wants to give this benefit (of converting Company into LLP) only to small companies.

Chapter I. Presumptive tax for small business/ profession:

19. Presumptive Taxation:

19.1 The **government** wants to **remove the difficulties** and **reduce burden on small taxpayers**.

Under the current laws of presumptive taxation, if the tax payer discloses at least **8% of the total turnover** as net profit, it is accepted without further enquiry. This scheme is **only** available for **persons carrying on business activities with a turnover up to Rs. 1 crore**. Further it is available only to individuals, HUFs and firms who are residents of India. LLPs, companies and others are not eligible. The scheme has been well-accepted by taxpayers as it removes the necessity of maintaining books of accounts. The department's burden is also reduced.

Suggestions were given by **Justice Easwar committee** (which was set up for **simplifying taxation norms)** for expanding this scheme. The **suggestions** have been **accepted** in the Budget to a certain extent.

This scheme is now available for both – income from **business** and income from **profession**. More details are given below.

19.2 Persons having Business Income: [S. 44AD]

19.2.1 The presumptive income relief is available to those whose turnover is upto Rs. 1 cr. It is proposed increase the limit to **Rs. 2 Crores.**

Previously no expenditure was allowed against such presumptive income except **remuneration** paid to partners and **interest on** capital paid to partners (subject to limits stated in the Act). It is now proposed to remove the benefit of claiming the deduction of remuneration and interest on capital. Thus now no expenditure can be claimed against such presumptive income. As no deduction will be allowed for partner's remuneration and interest, the partners will not be taxed on remuneration. They will not have to file the return (provided that they do not have any other taxable income and they do not have any foreign assets).

This will increase some tax liability as now tax will have to paid by the firm @ 30%. If remuneration is paid to partners, the firm saves 30% tax on the remuneration. This remuneration is taxable in partners' hands. The individual partners get an exemption of Rs. 2,50,000. Hence tax liability is lower in the hands of the partners. This will now not be possible.

19.2.2 Under the present law, if the person declares net profit of less than 8%, he is required to keep books of accounts and get the same audited. There is a change proposed in these provisions.

If a person has declared a profit of at least 8% under this section, and in **any of the subsequent 5 years**, he declares a profit of less than 8%, then for the next 5 years, he cannot be governed by this presumptive tax provision. In other words, such person's return may be scrutinised like any other return – whether he declares a profit in excess of 8% or not.

The Memorandum to the Finance Bill provides an example: A person declares a profit of 8% for AY 2017-18 and continues to do so till AY 2019-20. However, in AY 2020-21 he submits income to tax lower than 8%. Then he cannot get any relief of his income being accepted under this scheme from AY 2021-22 to AY 2025-26. He will have to maintain books of accounts and get the same audited.

Some assessees who have earned profit of lesser than 8% of the turnover, have taken the benefit of this provision by declaring profit of 8%. Then they do not maintain detailed books nor get the same audited. They compare the additional tax burden under this provision with the cost of maintaining books of accounts and getting them audited. They would take advantage of this provision selectively. If the tax burden is high, they would maintain the accounts and get the same audited. The Government would like the assessees to opt for this scheme on a long term basis and not selectively. Hence a period of 5 years has been brought.

19.2.3 **Currently,** advance tax is not **required to be paid** under this scheme. In the finance bill it is proposed that advance tax will be required to be paid only in 1 instalment by **15th March** of the respective year.

19.2.4 There appears to be an anomaly in the new provisions. If persons have a turnover of more than Rs. 1 crore but upto Rs. 2 cr., they may still need to obtain a **tax audit** report. This is because the limits have not been increased under tax audit provision (Section 44AB). Hopefully this should be corrected before passage of the Finance Bill in to an Act.

19.3 Persons having Income from profession: [S. 44ADA]

The scheme of Presumptive Taxation for persons having income from profession has been introduced for the first time in this Budget.

Under the proposed scheme, persons having **gross receipts** from profession of **up to Rs. 50 lakhs** are eligible to avail the benefits of the scheme. If the person discloses at least **50%** of the amount of the gross receipts as net profit, the return will be accepted without scrutiny. No

expenditure can be claimed against this income, including remuneration and interest paid to a partner by a firm.

If the person declares a profit of less than 50%, then he is required to keep his accounts and get the same audited.

This relief is applicable to residents of India. There is no restriction on the kind of persons who are eligible. Thus LLP and company are also eligible. Practically, there will be hardly any company with low income from profession. However if there are such companies, those will be eligible.

Unlike presumptive income from business, where **advance tax is payable only by 1 instalment, under this provision advance tax is required to be paid** as per revised provisions by 4 instalments.

Unlike the provision for business income, here there is no condition of declaring profits for 5 years.

19.4 No capitalisation:

It should be noted that the percentage of profits stated in these provisions is NOT a presumptive profit. It is actually a "**safe harbour**". If a person declares more profits compared to the rate prescribed, the department will not undertake any scrutiny. It will accept the profit disclosed in the return. It does not mean that he is not taxable on profits exceeding 8% of the turnover.

Let us assume that a person has a turnover of Rs. 1.5 crores. He earns a profit of 10% (Rs. 15 lakhs). Now if he declares a profit of 8% (Rs. 12 lakhs), the department will accept the return without questions. Thus he does not pay tax on Rs. 3 lakhs. He does this for 10 years. Over a 10 year period he would have an income of Rs. 30 lakhs (3 lakhs x 10 years) on which he would not have paid any tax. He shows this amount of Rs. 30 lakhs in his books as his capital. In this situation, the department can tax the same. Thus it is not a capitalisation section where you declare lower profit but disclose a higher amount as your capital. This is known as capitalisation of your assets without paying sufficient taxes.

This view is not shared by some professionals. We however believe that this section does not permit earning income in excess of prescribed percentage, and not paying tax.

A question to be considered is should such a person go under the Income Declaration scheme? (see para 13).

Chapter J. Provisions for Individuals:

20. Relaxation in condition for deduction of interest from income from house property: [S. 24]

Under the existing provisions, deduction for interest paid on borrowed capital for house property is allowed. For self-occupied property (which is not given out on rent), the normal deduction is Rs. 30,000. For property acquired after 1.4.1999, a higher deduction of Rs. 2,00,000 is allowed. For the higher deduction, the condition is that acquisition or construction of the property should be completed within 3 years succeeding the year in which capital was borrowed.

It is now proposed **to increase the time limit within which the acquisition or construction is completed from three to five years** succeeding the year in which capital is borrowed.

For property given on rent, there is no limit to the deduction of interest. There is no change in this.

21. Special provision for arrears of rent and unrealised rent received subsequently: [S. 25A]

The existing provisions related to taxation of income from house property provide separate tax treatment for "unrealised rent" and "arrears of rent". The unrealised rent and arrears of rent are currently taxed in the year in which they are realised or received respectively. A deduction of 30% was allowed on receipt of "arrears of rent". No such deduction was available for realisation of "unrealised rent".

It is now proposed to bring uniformity in tax treatment by extending the benefit of standard deduction of 30% to realisation of "unrealised rent".

22. Deductions in respect of rents paid: [S. 80GG]

Under the existing provisions, a deduction is available to an individual assessee in respect of rent paid for his home. This deduction is available to every individual who is employed but does not receive Housing Rent Allowance, and also to those who are not employed but have any other incomes. The deduction is available for rent paid in excess of 10% of the total income. The deduction is further restricted to 25% of the total income or Rs. 2,000 per month whichever is less.

It is proposed to increase this limit of Rs. 2,000/- per month to Rs. 5,000/- per month. Other conditions remain the same.

23. Deduction for individuals in respect of interest on loan taken for residential property: [S. 80EE]

The Act provided a deduction of up to Rs. 1 lakh in respect of interest paid on loan taken by an individual for acquisition of residential property subject to fulfillment of specified conditions. The deduction could be claimed in AY 2014-15 and 2015-16. (The deduction of Rs. 1 lakh is a total deduction over two years. It is not an annual deduction.)

It is proposed to grant the benefit of deduction for interest of upto Rs. 50,000/- per year. However, the deduction can be availed subject to fulfillment of following conditions:

(i) The loan has been sanctioned by a financial institution during FY 2016-17.

(ii) The amount of loan does not exceed Rs. 35 lakhs.

(iii) The value of residential house property does not exceed Rs. 50 lakhs.

(iv) The assessee does not own any residential house on the date of sanction of the loan.

The deduction under this section will be over and above deduction for interest on housing loan available up to Rs. 2,00,000/- under section 24 of the Act from income from house property.

If one interprets the language, the deduction is available under section 24 and also under section 80EE. However to take double deduction is not the objective. The logical way will be that the deduction will be first available under section 24 as it is a deduction available against the specific income. If anything is left, it can be claimed under section 80EE.

Further deduction of interest against house property income may result in a loss. This loss can be set off against other income. Whereas deduction under section 80EE will not be available if the person has losses.

Considering that all the conditions specified in the section are satisfied, the chart below explains how the deduction will be available under both sections.

Interest paid on Housing loan for Self-occupied property	Section of Income-tax Act	Deduction available
Rs.		Rs.
1,50,000/-	24	1,50,000/-
2,00,000/-	24	2,00,000/-
2,40,000/-	24 80EE	2,00,000/- 40,000/-
3,00,000/-	24 80EE	2,00,000/- 50,000/-

24. No deduction to be made in certain cases from Rent: [S. 197A]

Section 197A provides that tax shall not be deducted, if the recipient furnishes to the payer a self-declaration in prescribed Form No. 15G or 15H. The person has to declare that tax on his estimated total income would be nil.

This benefit is presently provided only on certain payments. It is proposed to amend the provisions of this section to include rental payments referred to in section 194-I. Thus house owners who give their house on rent can give a declaration so that the tenants will not deduct tax at source.

It may be noted that the declaration can be given only by resident owners of house and not by non-residents.

This amendment will take effect from 1st June 2016.

25. Rebate of income-tax in case of certain individual: [S. 87A]

Under the existing provisions, a rebate equal to 100% of the tax or Rs. 2,000/- whichever is lower is allowed to an individual resident whose net total income does not exceed 5 lakhs.

It is proposed to increase the limit of Rs. 2,000/- to Rs. 5,000/- so as to provide relief to small taxpayers. The rebate shall now be lower of 100% tax or Rs. 5,000/-.

Chapter K. TDS Provisions & TCS Provisions:

26. TDS Provisions:

The Finance Bill has proposed to revise the existing threshold upto which tax will not be deducted at source. Some rates of deduction of tax on various payments have also been reduced. The revision will provide relief to small taxpayers and also to other tax payers who find their funds blocked due to TDS provisions. The details of the changes are as follows:

(i) Revision of threshold limits:

Present section	Nature of Payments	Existing Threshold limit (Rs.)	Proposed Threshold limit (Rs.)
192A	Payment of accumulated balance due to an employee	30,000	50,000
194BB	Winnings from Horse Races	5,000	10,000
194C	Payments to contractor	Aggregate annual limit of 75,000	Aggregate annual limit of 1,00,000
194LA	Payment of Compensation on acquisition of certain immovable property	2,00,000	2,50,000
194D	Insurance Commission	20,000	15,000
194G	Commission on sale of lottery tickets	1,000	15,000
194H	Commission or brokerage	5,000	15,000

(ii) Revision of rates of deduction:

Present Section	Heads	Existing Rate of TDS (%)	Proposed Rate of TDS (%)
194DA	Payments in respect of Life Insurance Policy	2%	1%
194EE	Payments in respect of NSS Deposits	20%	10%

194D	Insurance commission	Rate in force (10%)	5%
194G	Commission on sale of lottery tickets	10%	5%
194H	Commission or brokerage	10%	5%

These amendments will take effect from 1st June 2016.

27. Tax Collection at Source (TCS) on sale of vehicles, goods or services in cash: [S. 206C]

TCS provisions mandate the seller to collect tax at source on sale of specified transactions from the buyer. Presently, goods such as alcoholic liquor, tendu leaves, etc. are covered. The tax varies between 1% and 5%.

27.1 On motor vehicles above Rs. 10 lakhs:

To enable the Government to bring high value transactions in the tax net, the Finance Bill proposes to cover sale of Motor Vehicle of a value exceeding Rs. 10 lakhs also within the TCS provisions.

The income-tax department has already amended rules whereby a person needs to mandatorily provide his PAN from 1st January 2016 on sale or purchase of any motor vehicle without any limit which requires registration (other than two-wheeled vehicles)! It creates an extra burden on transactions of such motor vehicles. Further, this provision will also apply to resale transactions.

27.2 On all cash transactions above Rs. 2 lakhs:

Further, the present provisions also cover cash transactions for sale of bullion and jewellery. To discourage cash transactions, it is proposed to also cover sale, exceeding Rs. 2 lakhs, in cash, of any goods or services (other than bullion or jewellery which are separately covered). To avoid double taxation on such transactions, tax is not required to be collected at source from amounts on which tax is deducted at source by the payer under Chapter XVII-B. However, these provisions will not apply to such class of buyers who fulfil prescribed conditions. The conditions have not yet been specified.

These provisions will come in to effect from 1st June 2016.

Chapter L. Compliance Provisions:

28. Auditing of Books of Accounts: [S. 44AB]

The government is committed to ease of doing business. It wants to reduce burden on small taxpayers. Therefore, threshold for auditing of books of accounts has been increased. The proposed changes are summarised in the table below:

Particulars	**Current limit**	**Proposed limit**
For income from business	1 crore	1 crore
For income from profession	25 lakhs	50 lakhs

29. Filing of return of Income: [S. 139]

To rationalise the time allowed for filing returns, completion of proceedings and realisation of revenue without undue compliance burden on the taxpayer, and to promote the culture of compliance, it is proposed to amend the following sections for filing of returns. **These amendments will apply from AY 2017-18**:

29.1 Due date of filing return: [S. 139(1)]

As per the current law, if total income of a person before availing deductions exceeds Rs. 2,50,000 (Rs. 3,00,000 for senior citizen of 60 years and above; Rs. 5,00,000 for very senior citizens of 80 years and above) then they are required to file the income-tax return.

Now it is proposed to amend this section and **include** exempt long-term capital gains from equity shares & equity-oriented funds on which STT is paid, for the purpose of computing limit of Rs. 2,50,000. Thus if the income including Long Term gain in listed shares and equity oriented funds exceeds Rs. 2,50,000, the person has to file a return. Even if there is no tax payable, tax return needs to be filed.

29.2 Belated return: [S. 139(4)]

As per the current law, income-tax return can be filed after the due date but before the expiry of one year from the end of the relevant assessment year; or before the completion of the assessment, whichever is earlier. Therefore, for the return to be filed by an individual for AY 2017-18, for which the due date is 31st July 2017, the last date by which a belated return can be filed would have been 31st March 2019.

It is proposed to reduce this time limit. Now, it is proposed that a belated return can be filed only **up to the end of the relevant assessment year** (i.e., **31st March, 2018** in our example above) or **completion of the assessment**, whichever is earlier. Therefore, assessees would only have a maximum of one year to file the tax return. If the return is not filed by then, it will mean that the tax payer has not filed the return and has concealed the income.

29.3 Revision of Return: [S. 139(5)]

As per the current law, belated returns were not allowed to be revised. **It is now proposed to amend the section by allowing even belated returns also to be revised**.

Revised return can be furnished at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier. There is no change in this provision. In our example in para 29.2 above, the person can now file the return and revise the return by 31st March 2019.

29.4 Defective Return: [S. 139(9)(aa)]

As per the current law, one of reasons why a return is regarded as Defective is - the Self-Assessment Tax together with interest had not been paid in full before filing the return. Defective return if not rectified within the time limit is treated as an Invalid return. It means that no return has been filed. Assessees were delaying filing their tax returns in cases where they could not pay the self-assessment tax by the return-filing deadline.

It is now proposed that even if self-assessment tax has not been **paid before filing the income-tax return**, it shall not be regarded as defective. It will be a **valid return**.

30. Filing of income-tax return for carry forward & set off of losses of specified business: [S. 139(3)]

Losses from specified businesses like cold storage, hotels, warehousing, etc. are allowed to be carried forward for an indefinite period [Section 73A]. Under the current law, if the return has been filed after the due date, losses from 'Business or Profession', 'Capital Gain' and 'Income from Other Sources' are not allowed to be carried forward. Losses from specified businesses were allowed to be carried forward even if the return was filed after the due date.

It is now proposed to amend the law to provide that losses from specified businesses will be allowed to be carried forward only if return is filed before the due date.

31. Time limit for assessment, reassessment and re-computation: [S. 153 & S. 153B]

It is proposed to reduce the existing time limits for completion of various assessments as follows:

Sr. No.	Particulars	Existing time limit	Proposed time limit
1	Completion of assessment u/s 143 & 144 (Scrutiny assessment) from the end of the assessment year	2 years	21 months
2	Completion of fresh assessment in pursuance of an order of ITAT or a revision of order by CIT, setting aside or cancelling an assessment from the end of the financial year in which the order is received / passed	1 year	9 months
3	Completion of reassessment (from the end of the financial year in which the notice was served)	1 year	9 months
4	Assessment of a partner in consequence of assessment of firm (from the end of the month in which order for firm u/s 147 is passed)	No time limit at present	12 months

The period of assessment or reassessment in Sr. Nos. 1, 2 & 3 above, is to be extended by a period of 12 months in cases where reference is made to a Transfer Pricing Officer.

The amendment will come into effect from 1st June, 2016 and will apply to all assessments taking place post this date.

Chapter M. Dispute Revolution Scheme:

32. Dispute resolution for disputes pending as on 29th February 2016: [Chapter X of Finance Bill 2016, Clauses 197 to 208]

32.1 The Government of India aims to create a tax friendly regime (this phrase has come at many places. We can remove these and keep it in the forwarding letter) and make India a better place to do business in. However, prolonged litigations has led to environment of distrust. Further litigation leads to increase in compliance and administrative costs. The Finance Minister in his Budget Speech has stated that there are about 3 lakhs cases pending before 1st Appellate Authority – i.e. Commissioner of Income-tax (Appeals). The disputed amount is Rs. 5.5 lakh crores.

To clear the backlog of cases, the Finance Bill 2016 has proposed a Dispute Resolution Scheme.

32.2 The scheme is applicable to amount of tax, interest and penalty which is under appeal with the first level appellate authority – Commissioner of Income-tax (Appeals). The appeal should be pending as on 29th February 2016.

The appeal can be pending for income-tax or wealth-tax.

The scheme will commence on 1st June 2016 and will remain in force till the date which will be notified by the Government. The person is required to file a declaration to opt for the scheme.

32.3 The amount payable under this scheme will be as under:

i) If the disputed tax is upto Rs. 10 lakhs, the person will have to pay tax and interest upto the date of assessment. There will be no penalty.

ii) If the disputed tax is more than Rs. 10 lakhs, the person will have to pay tax and interest upto the date of assessment. Further he will have to pay 25% of the minimum penalty payable.

iii) If the appeal is for penalty, the person will have to pay 25% of the minimum penalty payable. Further tax and interest upto the date of assessment will be payable on the income finally determined.

32.4 Dispute due to restrospective amendment in law:

The restrospective amendment in 2012 was made to tax capital gain earned by Hutchison on sale of Cayman Island company to Vodafone. The

Cayman Island company's value was derived substantially from Indian mobile phone service business. Hutchison transferred its Indian mobile phone service business by transferring the Cayman Island company. As the Cayman Island company, transferor and transferee were outside India, Hutch claimed that it was not liable to tax. The department argued that what Hutch sold was essentially Indian business. The department lost the matter in Supreme Court. Hence Government carried out retrospective amendment to tax capital gain. This restrospective amendment had caused anxiety within the foreign investors. Vodafone has gone for arbitration under the Bilateral Investment treaty.

Our detailed analysis is available on our website - http://www.rashminsanghvi.com/articles/taxation/vodafone/vodafone-case-its-consequences.html.

The Government has come forward with a resolution for such disputes which have arisen due to retrospective amendment. At the same time, it has reiterated that the Government has the power to bring in retrospective amendment. However it will not exercise the same indiscriminately.

If the appeal pertains to tax due to restrospective amendment, the tax payer can pay the tax without interest and penalty. In these cases, the matter can be in appeal at any stage – even in the Supreme Court, or it may even be at arbitration level. The tax payer can opt for this Dispute Resolution scheme.

The Government has said it has come this far to settle the matter. It is now left to the tax payer to consider the settlement.

32.5 If the tax payer opts for the scheme and pays the amount, the Government will provide immunity from prosecution and penalty which could otherwise have been undertaken.

The tax payer's appeal with the Commissioner (Appeals) will be considered as withdrawn.

In case of settlement of dispute for tax due to restrospective amendment, the tax payer will have to withdraw the appeal with the leave of the court if the appeal is lying with the court. If the tax payer has gone for arbitration, he will have to withdraw the proceedings from arbitration. He will also have to give an undertaking that he will waive his right to seek any remedy at any other forum.

The order for payment of amount will be given by the Commissioner of Income-tax within 60 days. The amount has to be paid within 30 days of the order.

32.6 This scheme is not available to following situations:

i) where assessment has been made in pursuance of search.

ii) where a search / survey has been conducted.

iii) where prosecution has been instituted before filing the declaration under the scheme.

iv) where it pertains to undisclosed income from a source located outside India or undisclosed asset located outside India.

v) where matter pertains to information received under a DTA.

vi) where certain detention orders have been made under the provisions of the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.

vii) for some offences under Indian Penal Code, the Unlawful Activities (Prevention) Act, 1967, the Narcotic Drugs and Psychotropic Substances Act, 1985, the Prevention of Corruption Act, 1988 or for the purpose of enforcement of any civil liability has been instituted on or before the filing of the declaration or such person has been convicted of any such offence punishable under any of those Acts.

viii) to a person notified under section 3 of the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992.

Chapter N. Penalty Provisions:

33. Penalty provisions: [S. 270A & S. 270AA]

33.1 It is proposed to amend penalty provisions for concealed incomes earned from FY 2016-17. Current penalty provisions continue to apply to concealed incomes earned upto FY 2015-16.

Under the current provisions, there are two stages for levying the penalty. In the first stage, the tax officer has to give an opportunity to the tax payer to explain his position. After considering the tax payer's explanation, he may not levy the penalty if he satisfied about the explanation. However if he not satisfied about the explanation, he may levy penalty between 100 and 300% of the tax sought to be avoided. This is considered to be discretionary.

The new provisions continue with this two stage penalty proceedings. However it has tried to bring in objectivity and reduce the discretion with the officer for levying penalty. Further the penalties are also lowered. (see para 33.4 also).

33.2 The new provisions provide that if there is an addition to income, the normal penalty will be **50%** of the tax on concealed income. However if the concealment is due misreporting, false entries, etc. the penalty will be **200%** of the tax on concealed income.

Further the tax payable on concealed income will be @ 30%.

33.3 The provision also provides that in the following circumstances the income will not be considered as concealed income if the tax officer increases the income. No penalty will be chargeable.

i) the person offers sufficient explanation to the satisfaction of the tax officer.

ii) where accounts are kept properly, however due to the method (of accounting) employed is such that income cannot be determined properly.

iii) for some issues which require an estimate, and if the tax payer has "estimated" a lower of amount of income, but the tax officer considers a higher estimate.

iv) where the tax payer has maintained proper records but the income is increased due to Transfer Pricing adjustment.

v) where penalty is levied in case of a search.

33.4 This reconfirms the fundamental principle that penalty is chargeable for intentional avoidance of tax. It cannot be charged if income is increased due to bonafide difference of views between the tax payer and revenue department.

The tax payer will be given an opportunity to explain his position. However once the tax officer decides to charge penalty, then he does not have any discretion. The penalty will either be 50% or 200% of the tax sought to be avoided.

33.5 Immunity from penalty and prosecution:

Another new section 270AA has been introduced to provide for immunity from penalty and prosecution. The tax payer has to make an application for the same within one month of passing of assessment order. The tax payer pays the tax and interest as per assessment order and does not file an appeal.

On receipt of such application and fulfillment of conditions, the tax officer will grant immunity from penalty and prosecution.

The provision permits the tax officer to reject the application for immunity. Before rejecting the application, he has to provide an opportunity to the tax payer for an explanation.

Chapter O. Other Provisions:

34. Relaxation in claim of allowance for new plant and machinery: [S. 32AC]

Section 32AC of Income tax Act was amended from AY 2015-16 to provide for an allowance of 15% on investment in new plant & machinery by a company engaged in activity of manufacturing or production of any article. The allowance is available till AY 2017-18. There were certain conditions regarding the same:

i. The investment should be more than Rs. 25 crores, and

ii. The acquisition and installation of new plant and machinery purchased has to be in the same financial year.

The above conditions were difficult to be fulfilled. It is thus proposed in the finance bill that while the acquisition of new plant and machinery can be done in any financial year, it must be installed before 31.03.2017 to claim the allowance. Thus, there is no compulsion of acquiring and installing new plant & machinery in the same year to avail the benefit of 15%. This is a beneficial amendment.

35. Period of holding for Long Term Capital Gain from sale of unlisted shares: [S. 2(42A)]

For gain on sale of unlisted shares to be considered as Long Term Capital gain, the period of holding was required to be of more than 36 months. This period is reduced to 24 months.

36. Clarification regarding set off of losses against undisclosed income: [S. 115BBE]

If any undisclosed incomes are detected by the department, the income is chargeable to tax @ 30% (plus surcharge and cess). No deduction is available for any expenditure or allowance.

However, there was uncertainty as to whether of set-off of losses against such incomes was allowed. It has been clarified that **set off of any loss shall not be allowable in respect of these incomes**.

The amendment will come into effect from F.Y. 2016-17.

Does it mean that for the past, losses can be set off? The matter is being litigated. The intention is not to give any relief against undisclosed income. However if a court decision rules that losses can be set off against undisclosed incomes, one will be able to take advantage of the same. This advantage will be upto FY 15-16.

37. Payment of interest on refund: [S. 244A]

As per the current law, interest on income-tax refund is paid from the 1st April of the assessment year to the date on which refund is granted.

In order to ensure filing of return within the due date it is proposed to provide that in cases where the return is **filed after the due date**, the period for grant of interest on refund may begin **from the date of filing of return**.

Presently, interest is provided only on excess amount on account of TDS, advance tax and TCS. It is now proposed to provide **interest on refund of self-assessment tax paid also**. Such interest shall be computed for the period beginning from the **date of payment of tax or filing of return**, whichever is **later**, up to the date on which the refund is granted.

Additional interest @ 3% is proposed where a refund arises out of appeal-effect being delayed beyond the time prescribed. The Finance Minister mentioned in his budget speech that there is a renewed thrust on use of technology for accountability of tax officers. In that sense, tax officers who delay such appeal-effect orders beyond 90 days will be held accountable for the extra 3% interest proposed above. This is a welcome move and hopefully should be a starter for shifting accountability on the tax officers who are responsible for delays or unreasonable additions to income.

These amendments will come into effect from 1st June, 2016.

38. Advance tax & interest on deferment in advance tax:

38.1 Advance tax: [S. 211]

Presently, due dates for payment of advance tax are different for corporate and non-corporate assessees. It is proposed to prescribe the same advance tax payment schedule for all assesses. The revised schedule for all tax payers will be as under:

Due date	Current Provisions	Proposed Provisions
15th June	Nil	15%
15th September	30%	45%
15th December	60%	75%

15th March	100%	100%

While the proposal seems to rationalise the provisions, it may be difficult for individuals and firms to estimate their annual income by 15th June to enable them to pay the advance tax accurately.

Tax payers opting for the Presumptive taxation scheme for businesses now need to pay advance tax only by way of one instalment by 15th March. However professionals who opt for presumptive taxation do not have this option of paying tax only once.

38.2 Interest on deferment in advance tax payment: [S. 234C]

As per Section 234C, interest @ 1% per month is required to be paid in case of default in payment of advance tax. As it is proposed to amend the advance tax payment schedule of non-corporate assesses, it is also proposed to make consequential amendments in section 234C. Now the interest on delayed payment of advance tax for both corporate and non-corporate assesses are same.

Additionally, it is also proposed that interest shall not be chargeable for assesse having Business or Profession income for the first time.

Annexure I

Income-tax rates

Person	Income limits	Tax rate (basic rate; surcharge; cess)
Resident - Individual, HUF, AOP, BOI, Artificial juridical person	Upto Rs. 1 crore	Maximum rate 30.9% (30%; 0%; 3%)
	Above Rs. 1 crore	Maximum rate 35.54% (30%; 15%; 3%)
Non-resident - Individual, HUF, AOP, BOI, Artificial juridical person	Upto Rs. 1 crore	Maximum rate 30.9% (30%; 0%; 3%)
	Above Rs. 1 crore	Maximum rate 35.54% (30%; 15%; 3%)
Firm and LLP	Upto Rs. 1 crore	30.9% (30%; 0%; 3%)
	Above Rs. 1 crore	34.6% (30%; 12%; 3%)
Indian company (Turnover or gross receipts do not exceed Rs. 5 crores in FY 2014-15)	Upto Rs. 1 crore	29.9% (29%; 0%; 3%)
	Above Rs. 1 crore and upto Rs. 10 crores	31.9% (29%; 7%; 3%)
	Above Rs. 10 crores	33.5% (29%; 12%; 3%)
Indian company (Turnover or gross receipts exceed Rs. 5 crores in FY 2014-15)	Upto Rs. 1 crore	30.9% (30%; 0%; 3%)
	Above Rs. 1 crore and upto Rs. 10 crores	33.1% (30%; 7%; 3%)
	Above Rs. 10 crores	34.6% (30%; 12%; 3%)

Foreign company	Upto Rs. 1 crore	41.2% (40%; 0%; 3%)
	Above Rs. 1 crore and upto Rs. 10 crores	42.0% (40%; 2%; 3%)
	Above Rs. 10 crores	43.3% (40%; 5%; 3%)

Annexure II

Phasing out deductions

The deductions given in the table below are proposed to be lowered or phased out over the next few years. The finance bill has proposed to reduce the corporate rate of tax to 25% for newly incorporated entities which are not going to claim any of the above said deductions. It is proposed to bring down the corporate rate to 25% for all corporate assesses over a period of 4 years.

Reduction in weighted deduction of expenditure:

Section	Weighted Deduction presently available (percentage of actual expenditure)	Proposed deduction (actual or percentage of actual expenditure)
35CCD – Expenditure on skill development project	150%	Actual expenditure from A.Y. 2021-22 onwards
35(1)(ii) – Expenditure on scientific research	175%	150% effective from A.Y. 2018-19 to A.Y. 2020-21 Actual expenditure from A.Y. 2021-22 onwards
35(1)(iia) – Expenditure on scientific research	125%	Actual expenditure from A.Y. 2018-19
35(1)(iii) – Expenditure on scientific research	125%	Actual from A.Y. 2018-19 onwards
35(2AA) – Expenditure on scientific research	200%	150% effective from A.Y. 2018-19 to A.Y. 2020-21 Actual expenditure from A.Y. 2021-22 onwards
35(2AB) – Expenditure on scientific research	200%	150% effective from A.Y. 2018-19 to A.Y. 2020-21 Actual expenditure

		from A.Y. 2021-22 onwards
35AD – Deduction in respect of specified	150%	Actual expenditure from A.Y. 2018-19 onwards
35CCC- Expenditure on notified agricultural extension projects	150%	Actual expenditure from A.Y. 2020-21 onwards

Complete Withdrawal of tax exemption:

Section	Deduction available presently	Proposed phase out
10AA – Special provision in respect of newly established units Special economic zones (SEZ)	Profit linked deduction for units in SEZ for profits derived from export of articles/things/services	No deduction to units commencing manufacture/production of article or thing or start of service from A.Y. 2021-22 onwards
32 read with Rule 5 – Accelerated Depreciation	100% depreciation for certain block of assets was available to certain industrial sectors	Rate of depreciation restricted to 40% effective from A.Y. 2018-19 onwards. New rate applicable from to **all assets (old and new)**
Section 80-IA – Deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development etc.	100% profit is deductible	No deduction if specified activity commences on or after 01.04.17
Section 80-IAB - Deductions in respect of profits and gains by an undertaking or enterprise engaged in development of Special Economic Zone	100% profit is deductible	No deduction if specified activity commences on or after 01.04.17
Section 80-IB –	100% profit is deductible	No deduction if specified

Deduction in respect of profits and gains from certain industrial undertaking other than infrastructure development undertakings		activity commences on or after 01.04.17

Some of the deductions mentioned above are currently available to "non-corporate" assesses as well. However, there is no proposal to reduce the tax rate for non-corporate entities. The non-corporate assesses are liable to pay @ 30%. This will create a disparity between corporate and non-corporate assesses. Against this disparity, profits distributed as dividends are liable to DDT whereas non-corporates are not liable to tax on distribution of profits. To the extent of DDT, the disparity is reduced.