Finance Bill, 2017

Analysis of Important Income-tax Amendments

RASHMIN SANGHVI & ASSOCIATES

Finance Bill, 2017

Analysis of Important Income-tax Amendments

RASHMIN SANGHVI & ASSOCIATES

Notes

This is an analysis of only the main Income-tax provisions of the Finance Bill, 2017. Particularly, procedural amendments are not included. To that extent, this is not an exhaustive listing of amendments proposed by the Finance Bill, 2017. The note has considered the provisions of the Finance Bill, 2017 as announced on 1st February 2017.

It provides an academic guidance to the proposals and is for general information. This analysis is not a legal advice. Readers may not take any decision based on this note. This note does not substitute the need to refer to the original bill.

Partners:

Rashmin C. Sanghvi

Naresh A. Ajwani

Rutvik R. Sanghvi

Rashmin Sanghvi & Associates
Chartered Accountants

220, 2nd floor, Arun Chambers, Tardeo Road, Mumbai - 400 034, India.
Tel. :(+91 22) 2351 1878, 2352 5694 • Fax: 2351 5275
Website: www.rashminsanghvi.com • E-mail: rashmin@rashminsanghvi.com

Date: 4th March 2017

Budget 2017 – Direct Tax Provisions
Analysis of Important Income-tax Amendments

This year's budget has been presented on 1st February instead of 28th February – breaking the colonial tradition. It will therefore be possible to make the amendments effective from 1st April 2017.

This budget does not contain major policy changes. It has however continued to tighten rules and plug the gaps. Some reliefs have been granted.

Though the budget does not have major tax changes, during the entire year, there have been important announcements made by the Government. This note therefore also covers important issues brought in during past one year.

We request you to go through the amendments pertaining to anti-avoidance measures particularly (Parts A and B).

In short, now if an assessee wants to do any tax planning; it will be as if he is Abhimanyu at the centre of a Chakra Vyuha. There are several legal provisions all ready to pounce on him. If caught, very serious consequences await him.

Probably, the position of an assessee can be presented by this simple chart given on the next page.

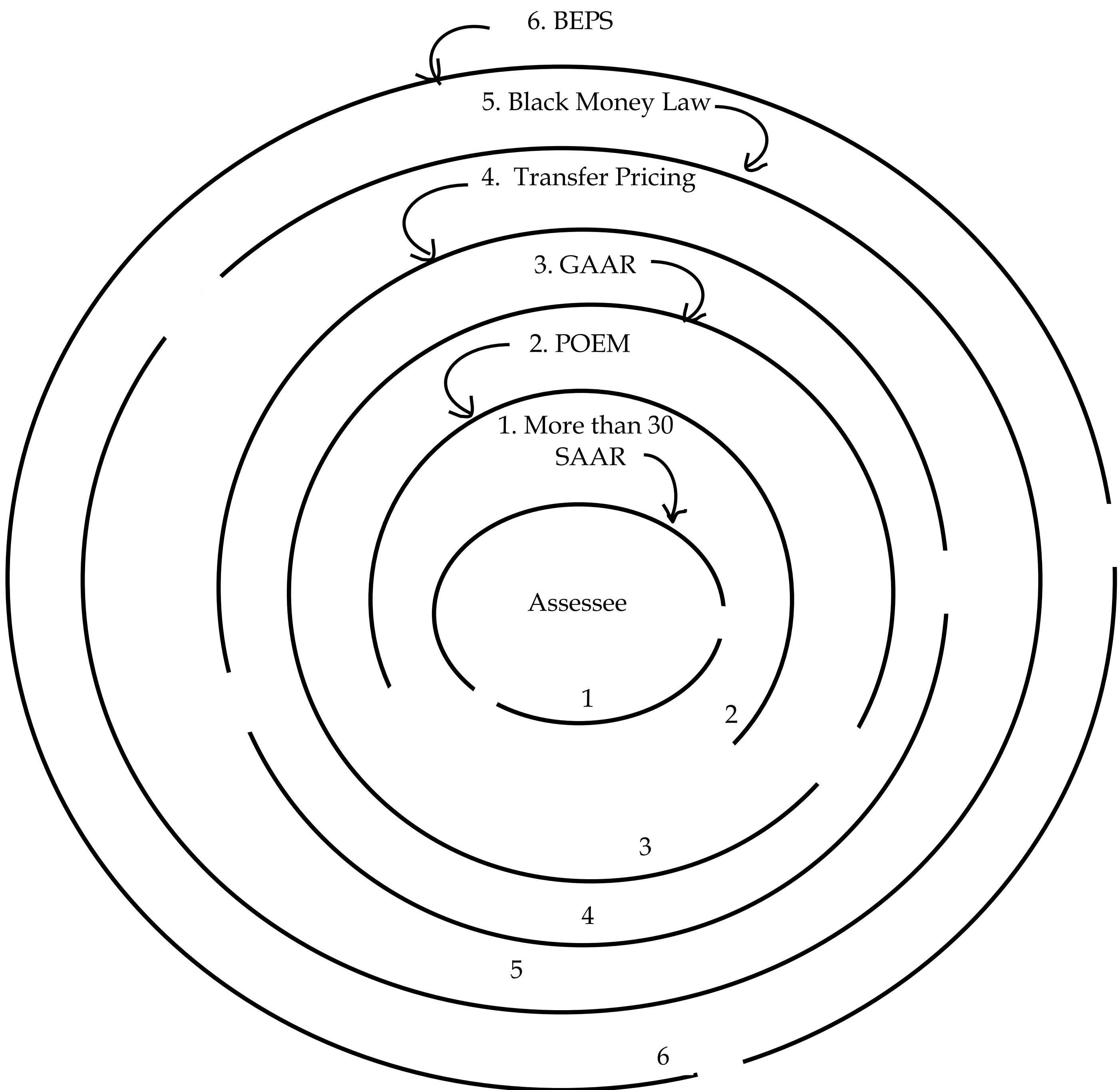
Most tax planning will meet the fate of Abhimanyu in Mahabharat. Some tax consultants relying on tax planning; and all tax havens are in for serious loss of business.

Now next few years will be required to digest all the anti-avoidance provisions.

The changes will be applicable from FY 2017-18, unless specified otherwise.

Kindly see the note. If you have any queries, you may contact us.

Yours sincerely,
Rashmin Sanghvi & Associates



Tax Law –
Tax, Interest, Penalty
Prosecution

FEMA
Seizure of assets

Abbreviations

Abbreviation	Full Form
AE	Associated Enterprise
ALP	Arms Length Price
AMT	Alternate Minimum Tax
AO	Assessing Officer
AOP	Association of Persons
AY	Assessment Year
BCAS	Bombay Chartered Accountants' Society
BEPS	Base Erosion and Profit Shifting
BOI	Body of Individuals
CbCR	Country by Country Reporting
CBDT	Central Board of Direct Taxes
CFC	Controlled Foreign Company / Corporation
DR	Development Rights
DTA	Double Tax Avoidance Agreement
EBITDA	Earnings before Interest, Tax Depreciation and Amortisation
EU	European Union
FEMA	Foreign Exchange Management Act
FII	Foreign Institutional Investor
FY	Financial Year
G20	Group of 20 Countries
GAAR	General Anti-Avoidance Rules
HUF	Hindu Undivided Family
ICDS	Income Computation and Disclosure Standards
Ind-AS	Indian Accounting Standard
ITA	Income Tax Act
JDA	Joint Development Act
MAT	Minimum Alternate Tax
MCA	Ministry of Corporate Affairs
MF	Mutual Funds
MLC	Multi Lateral Convention
MNC	Multi National Company/Corporation
NHAI	National Highways Authority of India
NR	Non-Resident
OCI	Other Comprehensive Income
OECD	Organisation for Economic Co-operation and Development
PE	Permanent Establishment
POEM	Place of Effective Management
REC	Rural Electrification Corporation
S/Ss	Section/Sections
SAAR	Specific Anti Avoidance Rules
SC	Supreme Court
SCRA	Securities Contract (Regulation) Act
SEZ	Special Economic Zones
SPV	Special Purpose Vehicles
TDS	Tax Deducted at Source
TPO	Transfer Pricing Officer
U/s	Under Section

Finance Bill, 2017

Analysis of Important Income-tax Amendments

Contents

A. Anti-Avoidance measures 1

B. BEPS – Base Erosion & Profit Shifting 6

C. International Taxation and Transfer Pricing 8

13. Foreign Tax Credit Rules (FTC) [S. 295(2)(ha), Rule 128] 8
14. Indirect Transfer – Capital Gain [S. 9(1)(i), Explanation 5A] 12
15. Thin capitalisation – disallowance of interest expenditure [S. 94B] 13
16. Secondary adjustment in case of Transfer Pricing [S. 92CE] 17
17. Tax on Capital Gain on shares of a Private Company earned by a non-resident [S. 112(1)(c)(iii), Clause 43 of Finance Act 2012] 20

D. Encouraging Digital Economy; Discouraging Cash transactions 21

18. Disallowance of Capital and Revenue Expenditure in cash [S. 35AD & 40A(3)] 21
19. Restriction on receipt of income in cash [S. 269ST, 271DA] 22
20. Other concerns 23

E. Business transactions 23

21. Minimum Tax and credit for Minimum Tax [S. 115JAA & 115JD] 23
22. Rationalisation of provisions of MAT in line with Indian Accounting Standard (Ind-AS) 24
23. Real Estate Joint Development Agreement (JDA) [S. 45(5A), 49(7) & 194-IC] 25
24. Restriction on set off of loss against income of units in Special Economic Zones [S. 10AA] 26
25. Domestic Transfer Pricing [S. 40A(2)(b), 92BA] 28
26. Increase in limits for maintenance books of accounts [S. 44AA] 29
27. Increase in limit for audit for businessmen opting for presumptive taxation scheme [S. 44AB] 29

F. Specific Anti-Avoidance Measures 29

28. Anti-avoidance rule for Penny Stock scams [Section 10(38)] 29
29. Tax on receipt of money and certain specified assets without consideration or for insufficient consideration [Section 56(2)(x)] 31

G Capital gain 33
30. Reduction in the time period for holding of Immovable Property for Long Term Capital Gain [S. 2(42A)] 33
31. Consideration for sale of unquoted shares at lesser than fair market value [Sec 50CA] 33
32. Conversion of Preference Shares into Equity Shares [S. 2(42A), 47(xb) & 49(2AE)] 35
33. Shifting of base year from 1981 to 2001 for Computation of Capital Gains [S. 48 & 55] 35
34. Consolidation of plans within a scheme of Mutual Fund [S. 2(42A), 47(xix) & 49] 36
35. Expanding the list of long-term bonds for Capital Gain tax relief [S. 54EC] 36
H. Other changes 36
36. Advance tax related amendments 36
36.1 Advance tax instalment for professionals [S. 211] 36
36.2 Advance tax on domestic dividends [S. 234C] 37
37. Taxation of dividend [S. 115BBDA] 37
38. Deduction of tax at source from rent payments in case of Individuals and HUFs [S. 194-I] 38
39. Restriction on set-off of loss from house property [S. 71] 38
40. Rates of Income tax 39

Analysis of Important Income-tax Amendments

A. Anti-Avoidance measures:

1. The Governments across the world have been enacting anti-avoidance measures to plug tax leakages – especially after the US crisis of 2008. India is an active participant in the Global fora of G20 and OECD. Several countries look forward to Indian measures for plugging tax leakages.

2. There are different colours given to tax planning. These are as under:

i) **Tax planning** is - considered as steps taken to take advantage of tax reliefs provided by the Government. These steps have substance – i.e. the transactions are bonafide. However, now even "tax planning" has acquired a negative meaning.

ii) **Tax Avoidance** is - taking legal steps to reduce tax. These steps are more in form than in substance. In cross border transactions, these involve taking advantage of different tax rules to reduce tax. When tax rates were high, tax avoidance, by taking just legal steps, was considered all right by the courts. Now with tax rates low, courts also frown upon tax avoidance – even if it is legal.

iii) **Tax evasion** is - outright fraudulent steps to avoid tax.

The above divisions are not water-tight. There can be overlap of all three divisions.

2.1 With various anti-avoidance measures, there will be no difference between Tax Avoidance and Tax Evasion. Importance will only be for **Substance** and not the **Form**. Please refer to our note on GAAR in the Budget document of 2012 for more details at

http://www.rashminsanghvi.com/downloads/taxation/budget_notes/Finance_Bill_2012_An_Analysis.pdf.

2.2 As far as Tax Planning is concerned, it will involve – availing tax relief where it is specifically provided (e.g. obtaining tax relief provided for specific industries).

2.3 Now **Tax Risk Mitigation** will be important – how to comply with the law and avoid penal consequences, rather than avoid any taxes.

3. Various steps taken by the Government for Anti-Avoidance:

The following gives a list of measures which have been taken by this Government since 2014 when it came to power.

3.1 Enacting **Black Money Law** for untaxed foreign income. It has penal and prosecution provisions for evasion of tax on foreign income. Legally the law can apply to untaxed foreign incomes however old the incomes may be. In other words, even the time limit of sixteen years can be crossed by the tax department.

3.2 Similarly, in case of foreign assets which were acquired in violation of FEMA regulations, there can be a seizure of Indian assets of equivalent value – only on the basis of suspicion! See our note on the same here:

http://rashminsanghvi.com/downloads/taxation/international-taxation/Budget_2015_Direct_Tax_and_FEMA.htm#I

3.3 **Income Declaration Scheme** where untaxed Indian income was taxable at 45% without penal consequences. Those who have not availed of the scheme will now be liable for penal consequences. The period for taxing past incomes is proposed in this Finance Bill to be increased **to 12 years** from 8 years from the beginning of financial year (in case of search or survey operation). Beyond a period of 12 years, if Indian income has escaped tax, no action can be taken.

3.4 Enactment & Implementation of **Benami Property Law**. Any property which is held Benami can be confiscated and concerned persons can be prosecuted.

3.5 **Demonetisation:** Old notes of Rs. 500 and 1,000 were cancelled. Further, those who have deposited the old notes in banks exceeding Rs. 2.5 lakhs between 8th November and 30th December, have to give explanation online under Operation Clean Money as initiated by the tax department.

3.6 **Restrictions on use of cash** for transactions. Beyond the specified limits, there are penal consequences introduced as part of this Budget.

3.7 **POEM:** Place of Effective Management (POEM) – POEM test has been incorporated in the ITA for foreign companies. If a foreign company has POEM in India, it will be considered as resident of India. Thus Indian residents opening shell companies abroad to park their incomes without tax has been plugged. See our note on our website at http://www.rashminsanghvi.com/downloads/taxation/international-taxation/place_of_effective_management(poem).htm.

3.7.1 The Government had issued draft guidelines for public comments.

3.7.2 The guidelines have been recently finalised. These are almost on the same lines as the draft guidelines. One will have to establish substance that management of the foreign company is outside India.

3.7.3 While the provision in S. 6(3) is quite wide, the Guidelines & Press note published in January, 2017 have given a substantial relief. As per the Press note and Circular 8/2017 all foreign companies having annual turnover of less than Rs. 50 crore will not be covered under S. 6(3).

This is a beneficial announcement.

3.7.4 i) This limit of Rs. 50 cr. is stated in the press release. It was not stated in the circular issuing guidelines. However, CBDT has clarified vide Circular 8/2017 that POEM guidelines will not apply to companies having turnover of less than 50 cr. This is even more liberal than the old definition of residence (wholly controlled from India).

ii) One can debate that the guidelines themselves are just that – only a guide. Do they have statutory force? Section 6(3) provides that foreign company with POEM in India will be considered as Indian resident company. The section nowhere gives powers to the Government to specify any guidelines. Section 6(3) is complete in itself.

Hence even the guidelines legally are doubtful of statutory force.

However the intention of the Government is clear that they would like to give relief to foreign companies which have a turnover of Rs. 50 cr. or less.

3.8 **GAAR** – GAAR has been made effective from FY 2017-18. It applies to domestic and International transactions. The department has the power to consider whether a transaction or a group of transactions is designed to avoid tax. CBDT has issued guidelines for GAAR (Circular No. 7/2017 dated 27th January 2017).

3.8.1 To have some safeguards, it has been provided that if the effect of the transaction is less than Rs. 3 cr., then GAAR will not apply.

3.8.2 ITA and DTA have Specific Anti-Avoidance Rules (SAARs). E.g. in case of sale of immovable property, the minimum sale value to be considered will be the stamp duty value. It is to take care of sale of property at undervaluation. If there is a SAAR, can GAAR apply? The guidelines

state that SAAR may not cover every tax planning. Hence even if SAAR is there, GAAR can apply.

3.8.3 Rule 10U(1)(d) states that GAAR will not apply to income from transfer of capital asset if the assets have been acquired before 1.4.2017. Such relief is also available in Mauritius, Singapore and Cyprus DTAs. This has important implications.

3.8.3.1 The relief is only for capital gain and not for income from the asset. For example, if a non-resident has invested through Mauritius in Indian shares before 1.4.2017, capital gain on sale of the same is still exempt from tax. However income on the same, say dividend, will not get any relief. The relief on capital gain is referred to as "grandfathering".

3.8.3.2 Further, grandfathering will not apply to **arrangements**. It means investment structures through Mauritius will be covered under GAAR. If there is any further investment made through the Mu. Company, it will not get relief. Only the original investment will get relief – for capital gain.

3.8.3.3 There were questions as to what happens to investment made in convertible debentures before 1.4.2017 which get converted into shares after 31.3.2017. Will these shares get the DTA relief? The department has clarified that relief will be available to such shares. Relief has also been provided for bonus shares received after 31.3.2017 and shares acquired on account of amalgamation and demerger.

3.9 Amending **DTAs with Mauritius, Singapore and Cyprus** to remove the relief of Capital Gain tax and bringing in provisions for limitation of treaty benefits only to bonafide cases.

4. Steps recommended by G20 and OECD:

4.1 Internationally, G20 / OECD have proposed measures to avoid Base Erosion and Profit Shifting (BEPS) (In simple words, 'Tax Planning'). There are 15 BEPS Action reports running into 2,000 pages. Based on these reports, the countries have signed Multilateral Convention by which all the Double Tax Avoidance Agreements will be amended with one document. These measures will target tax avoidance. (See Part B for more details.)

4.2 There are several steps in these reports. India has already started taking these steps. Some of these are:

i) **Country by Country Reporting:** The MNCs who have group turnover of Euros 750 mn. or more, will have to report their key financials with respect to each country. These will help in identifying

the areas where there could be tax avoidance due to Transfer Pricing. Refer to our budget note 2016 below:

http://www.rashminsanghvi.com/downloads/taxation/international-taxation/Budget_2016_Direct%20_Tax%20_Provisions.htm

ii) **Automatic Exchange of Information** between various countries. If any country comes across information pertaining to a covered transaction of a resident of another country, it will be obliged to share the same with the respective country. Exchange has started with quite a few countries. These will start in a full-fledged manner by 2018.

iii) Amending the DTAs to **strengthen Permanent Establishment Rules**, **avoid double non-taxation**, place restriction on interest expenditure paid to related parties abroad and similar other measures to prevent tax avoidance.

iv) **Controlled Foreign Corporation Rules** have been recommended. This will prevent passive incomes like dividend, interest, etc. to be parked in a group company in a tax haven. There is no official mention for CFC

v) Signing **Tax Information Exchange Agreements**.

vi) Introducing **Limitation of Benefits clause** in the DTAs.

4.3 All these will result in capturing the income in the country where it arises. Parking incomes in tax havens will become extremely difficult.

4.4 Already the business of tax havens has gone down. It will go down further.

5. Challenges ahead:

5.1 Having said this, one should note that there is no resolution on differences in tax systems, or rules of different countries. For example, if an Indian company purchases goods from its subsidiary in UK. The Indian Transfer Pricing Officer (TPO) can allege that purchase is at a high cost. Hence he will reduce the purchase expenditure and increase the income. Will the UK revenue reduce the income of the subsidiary? (This is called Compensatory Adjustment.) If UK does not agree to reduce the income, then there will clearly be double / excess taxation.

The classic example is of tax on Apple – manufacture of iPhones and iMacs. It has a subsidiary in Ireland through which it sells its products to

customers outside USA. Sale also happens within the European Union. The European Commission (EC) has alleged that Ireland has given excessive tax relief to Apple. It has asked Ireland to raise a tax demand of Euros 13 bn. The US Government, Irish Government and Apple have said the European Commission's demand is incorrect and that Irish Government has followed the rules.

The irony is that Ireland, which is a part of EU, is not willing to raise the demand. Ireland is a small country and it has got its desired revenue from Apple. It does not need more. This has become a "Tax War" between US and EU. Both – Irish Government and Apple have filed appeals against EC order. Let us wait and see what happens.

5.2 There are umpteen such issues which one will have to deal with.

5.3 The rules based on BEPS reports are extremely complicated. The tax departments, tax professionals and businessmen will have to spend efforts to understand these.

B. BEPS – Base Erosion & Profit Shifting:

BEPS means "Tax Avoidance" or "Tax Planning". **G20 & OECD** together have prepared a package of actions against tax planning. It contains fifteen Action Reports. By now more than a hundred countries have concluded negotiations on **Multi-Lateral Convention** (MLC). The MLC will be signed in June 2017. Once it comes into effect, considerable tax planning will become redundant. Some Recommendations of BEPS have been already introduced in Budget 2017. Some of the BEPS reports are briefly mentioned below.

For a detailed explanation one may view the web-cast of a presentation or BEPS. Presentation was made by our partner Mr. Rashmin Sanghvi and broadcast by Bombay Chartered Accountants' Society (BCAS). It is available on **You Tube** at –
https://www.youtube.com/watch?v=ZjtwH7tW1sI.
Title to the programme: "Is BEPS answer to Tax Planning?"

6. **Treaty Shopping:** Non-Residents of India including MNCs, FIIs & NRIs invest in India through tax havens like Mauritius, Singapore etc. Under **Action Report No.6** and MLC, this planning will no longer be possible. India can deny tax treaty benefits for investors resorting to "treaty shopping". This will be permissible under MLC and will not amount to "Treaty Override".

7. **SPV**: Many Indian residents invest abroad through Special Purpose Vehicles – SPVs. These are companies etc. formed in tax havens for holding

investments in other countries. For example, many Indians have incorporated companies in UAE for holding foreign investments.

Under **Action Report 3** on **Controlled Foreign Companies** – CFCs, a Government can tax the global income of such foreign SPVs.

India has adopted a different path – Place of Effective Management or **POEM**. This law was passed in the year 2015 and has become effective from 1st April, 2016. CFC provisions have not been incorporated in Indian Income-tax Act. While the purpose of POEM and CFC is similar, there are some important differences between two concepts. CFC provisions are concerned more about ownership. POEM provisions are concerned more about management.

Recently, Government has released guidelines softening the harshness of the law. This has already been discussed in para 3.7 above.

8. Transfer Pricing:

Transfer Pricing is already a strong measure against Indian assessees. It has been strengthened further under **Action Reports 8, 9 & 10**.

9. Interest Expenditure:

Subsidiaries and branches of foreign companies may try to reduce Indian tax liability by payment of excessive interest. BEPS **Action 4** makes several recommendations on curbing this tax planning. Budget 2017 has proposed S. 94B for limiting interest expenditure to such companies and permanent establishments. Refer to Para 15.

10. E-Commerce:

E-Commerce companies like Google, Facebook etc. avoid income-tax in the countries where they sell their goods and services. **Action Report 1** under BEPS has discussed different alternatives to curb this tax avoidance. India has introduced **Equalisation Levy** under Section 163 – Section 180 of Finance Act, 2016. A 6% tax has been imposed on E-Commerce payments by Indian residents to non-residents.

CBDT has constituted E-Commerce Committee to make further recommendations on Equalisation Levy. The Committee's final report is pending. Budget 2017 has no new provisions on E-Commerce taxation.

11. Avoiding PE:

Some Non-Residents avoid – their business within India – being termed as Permanent Establishment (PE). Hence they avoid Indian taxes. **Action Report No.7** prevents this tax planning.

12. Treaty Abuse:

Double Tax Avoidance Agreements (DTAs) are signed to avoid double taxation of international incomes. People have used these agreements to completely avoid tax or have **Double Non-Taxation**. Indian judiciary had contradictory decisions. However, finally, SC has approved of Treaty Shopping.

SC decision in **Azadi Bachao Andolan** (it permitted Double Non-Taxation) & AAR ruling in **Cyril Pereira** (it did not permit Double Non-Taxation) case are illustrations.

Now BEPS **Action Reports 5 & 6** propose provisions against such tax planning. Under MLC it is clearly declared that DTAs are not meant for Double Non-taxation & treaty abuse. It is clearly declared that **"Substance" shall prevail - over "Form"**. With this declaration, an important controversy is resolved in favour of tax department.

C. International Taxation and Transfer Pricing

13. Foreign Tax Credit Rules (FTC) [S. 295(2)(ha), Rule 128]:

13.1 Indian residents earning income abroad on which tax is paid in a foreign country, are eligible for credit for such foreign tax paid. While the DTA and Income-tax Act permit Foreign Tax credit (FTC), there were no rules / procedures. Only basic principles were laid down by the Courts. This resulted in assessees being denied credit in many cases.

The Government came out with rules on FTC vide Notification dated 27.6.2016. These are effective from A.Y. 2017-18. Some of the rules have been incorporated in the ITA by this Finance Bill.

The key provisions of FTC specified in the notification and finance bill are discussed below.

13.2 FTC will be available on that income which is doubly taxed – in India and the foreign country. It is restricted to the Indian tax or the foreign tax whichever is lower. Thus if foreign tax is more than the Indian tax, the excess will not be available.

If the foreign income to be taxed in India is spread over more than one year, FTC will be allowed proportionately over that many years. It will be available against each source of income separately. See Example 1 below.

Example 1:
An Indian resident earns income in UK which is taxed as under:

Source	Amount	Tax
Interest	1,000	200
Business	1,000	400

In India the income is taxable @ 30% irrespective of the source. How much credit will be available? The FTC in India will be as under:

Source	Amount	Tax
Interest	1,000	300
Business	1,000	300
Total	**2,000**	**600**
		===
Less: FTC for UK tax		
On interest		200 (restricted to actual UK tax)
On Business		300 (restricted to Indian tax)
Net payable in India		**100**
		===

Excess tax in UK on Business income, cannot be set off against tax on interest in India.

FTC will be available against income-tax, surcharge and cess. It is however not available against interest, fee or penalty. This is a good clarification.

13.3 The FTC will be available in the year in which the foreign income is submitted to tax in India. It will be proportionate to the amount which is taxable in India.

Example 2:
In the US, calendar year is followed for taxation. In India, the tax year is 1st April to 31st March. An Indian resident has earned US income for 2016. In India, the US income for 9 months (1st April to 31st December 2016) and 3 months (1st January to 31st March 2017) has to be submitted to tax.

In what manner will the FTC be available in India?

Tax paid for 2016 in US will be considered proportionately for 9 months. Similarly, tax paid for 3 months of 2017 will be considered proportionately.

However the tax return in India has to be filed by 31st July / 30th September. How does one get credit for US taxes? The final tax for 2017 will be known somewhere by March / April 2018.

In such cases, the tax return in India will have to be filed based on the basis of tax paid in US till the time of filing the Indian tax return. When the final tax amounts are known by March 2018, the return in India will have to be revised. Additional tax will have to be paid or a refund will have to be claimed.

FTC rules provide for some situations where foreign tax amount is not finalised. However it does not take care of all such situations.

13.4 If tax amount is disputed abroad or a refund of tax is claimed, credit will not be available for that amount. In the year in which the dispute is finally settled, credit will be available.

In such situations, the dispute will normally be settled after a few years. The final FTC will be available for the year in which the income has been offered for tax.

Thus in the example in para 13.3, if the resident disputes some tax in the US for 2016 and that dispute is settled and tax is paid in 2020, the FTC will be available in 2020 for the final tax paid – but for the year 2016-17.

13.5 The tax payer is required to submit the following documents:

i) Form No.67 with details of foreign income and tax paid.

ii) Further, Certificate or statement specifying the nature of income and the amount of tax deducted therefrom or paid by the assessee is also required from any of the following:

(a) from the tax authority of the country or specified territory outside India; or
(b) from the person responsible for deduction of such tax; or
(c) by the assessee:

The statement by the assessee should be accompanied by –

(A) an acknowledgment of online payment or bank counter foil or challan for payment of tax where the payment has been made by the assessee;
(B) proof of deduction where the tax has been deducted.

The above documents should be furnished by the due date of filing the tax return.

13.6 The rules clarify that FTC will be available against Minimum Tax payable by companies or other persons. (See paras 21 and 22 for more details about MAT). If there is FTC against MAT, the credit for MAT in subsequent years is reduced. This is a simple computation. However the language in the rules is complicated (Rule 128(7)). Hence we have explained the same with an illustration.

Example 3:

An Indian company has a taxable income of Rs. 100. Book profit as per MAT provisions amounts to Rs. 190. The amount of tax paid in foreign countries is Rs. 32.

In what manner will FTC be available against tax payable in India?

Particulars	Income	Rate of tax	Tax	
Normal provisions (1)	100	30%	30	
As per MAT (2)	190	18.5%	35	(approx.)
Tax to be paid (Higher of 1 or 2)			35	
Normal MAT credit for subsequent years	---	--------	5	
Less: FTC			(32)	
Tax to be paid			**3**	
MAT to be carried forward to subsequent years			**3**	

Thus to the extent MAT is actually paid less, no credit for the excess MAT will be available.

13.7 In some countries, **the losses can be carried backwards**. For example, in year 1, an Indian company has earned income in Australia. Tax has been paid – say 1,000. This has been set off against tax in India.

13.7.1 In year 4, there is a loss in Australia. In India, such a loss can be **carried forward** and set off against future income. However let us assume that in Australia, the loss can be **carried backward**. Thus the loss of year 4, can be set off against income of year 1. Tax will be refunded – say 250. Net tax paid in Australia for year 1 will be 750. Whereas in India, credit for 1,000 would have been claimed. Thus in India, it results in excess credit to the extent of 250 for year 1.

13.7.2 The rules provide that in such cases, Form 67 should provide such details. However in which year should the Indian company pay this additional tax, has not been specified. Will the tax have to be paid in year 1 or year 4? Logically it should be year 1. It will however mean that an old return will have to be revised. Further interest on the same will have to be paid. This will become unfair as the Indian company has not enjoyed the excess credit of 250. It was paid to Australian Government. Now it will be paid to Indian Government. Practically it may be provided that the tax in such cases should be paid in the year in which the refund is received by the Indian company from the foreign Government.

14. Indirect Transfer – Capital Gain [S. 9(1)(i), Explanation 5A]:

14.1 Indirect transfer provisions were introduced in 2012 to overcome the SC decision in the case of Vodafone. Briefly, Hutchison Hong Kong sold shares of a Cayman island company to Vodafone Netherlands. Through this transaction, Hutchison sold the Indian mobile telecom business "indirectly" and avoided income-tax on the ground that the transaction is for a foreign company's share outside India and between non-residents. Hence India does not have jurisdiction to tax. The tax department raised a demand of US$ 2 billion. The Supreme Court ruled in favour of Vodafone. Kindly see our detailed note available at the following link:

http://rashminsanghvi.com/downloads/taxation/budget_notes/Finance_Bill_2012_An_Analysis.pdf

14.2 The amendments in the law to overcome the Vodafone decision provided that if the foreign entity derives substantial value from India, then the share or interest in the foreign entity will be considered to be "in India". Thus if Indian assets are sold indirectly through foreign entities, the gain will be taxable in India. The amendments however had some unintended consequences / concerns. For example: "How should substantial value be determined?" "How much is substantial value?" "Will even small shareholders be taxed if they sell shares on stock exchange abroad?" "Will dividend declared by the foreign company to foreign shareholders also be taxed?".

Some of these were resolved in 2015 and 2016 by further amendments in the law and issue of rules. Substantial value has been explained to mean that if the foreign company derives its value from assets in India exceeding Rs. 10 cr. and forms 50% or more of the total value of its global assets, substantial value will be considered as in India. Similarly shareholders holding less than 5% interest in the foreign company and who do not have management rights, will be exempt from Indirect transfer provisions.

14.3 In 2015, CBDT issued a circular (No. 4 dated 26.3.2015) stating that indirect transfer provisions are deeming provisions. They have to be interpreted strictly. The provisions apply to transfer (sale). These do not apply to dividends. Thus if foreign company declares dividend to foreign shareholders, the same will not be taxable in India.

14.4 One of the issues is – if there is a multi-level structure through which shares in an Indian company are held, will it give rise to multiple taxation? For example, Foreign company 1 (FCO1) holds shares in FCO2; FCO2 holds shares in FCO3; and FCO3 holds shares in Indian company. If FCO1 sells shares in FCO2, it will be taxed in India. When FCO2 sells shares in FCO3, again it will be taxed.

14.4.1 Various representations were made. CBDT issued a circular (No. 41 of 2016) essentially stating the law. In vertical structures, there will be multiple taxation.

14.4.2 Again the investors represented. The Finance Bill now provides that in case of **FIIs which are registered as category 1 or category 2** with SEBI, investors in those FIIs will not be taxed when they sell their investment in the FII. Thus in case of FIIs, there will be one tax when the FII sells the shares. There will be no further tax when the investor sells the shares/units in the FII. In any case, FIIs largely earn Capital gain on sale of listed shares. Long Term gain on such shares is exempt. It led to a situation where the primary gain is exempt in the hands of FII, but sale of units of the FII by the investor of the FII is taxable. This situation has now been resolved.

14.4.3 However in case of other foreign investors – e.g. Venture Capital funds, Private Equity investors, etc. multiple tax remains. All investors in the structure where ultimately the value is substantially from India, remain taxable.

14.5 The amendment is proposed from 1st April 2012 (when indirect tax provisions were enacted). However the indirect tax provisions have been made applicable from 1.4.1961. Hence the exemption to investors in FIIs also will be applicable from 1.4.1961.

14.6 This has been our suggestion even before. We re-emphasise, that multiple level structures will not be useful. On the contrary they may cause harm. It is better to hold investments directly than through intermediate structures.

15. Thin capitalisation – disallowance of interest expenditure [S. 94B]:

15.1 Foreign investors can normally remit profits out of India when the Indian company declares dividend. There is an additional tax on dividend.

The dividend is not deductible as expenditure. Thus there is double tax – on profits of the Indian company, and again on dividend.

One of ways in which a foreign investor can remit profits out of India without tax or lower tax is to charge expenses to its Indian subsidiary. The expense in the Indian subsidiary reduces the profits. The corresponding income may be taxed in India or may not be taxed – depending on the kind of expenses. However there is only one tax.

15.2 One of the expenses which the foreign investor charges to the Indian company is interest. This is done by providing a loan by the foreign investor to the Indian subsidiary - apart from equity capital. (FEMA has its own restrictions on foreign loans. However that is a different subject. Under FEMA, it is possible for a foreign shareholder to provide loan to an Indian subsidiary.)

Higher the debt, more is the interest which can be claimed. High debt means less equity (thin equity). This is known as "Thin capitalisation". Hence under Thin Capitalisation rules, usually there is a limit on debt-equity ratio. If the loan is in excess of permitted debt-equity ratio, then the interest corresponding to excess loan is considered as dividend for income-tax purpose and taxed accordingly. Thus the benefit of debt is not available.

15.3 The finance bill provides a limit on the interest which can be allowed under ITA. Instead of providing a limit on **debt-equity ratio**, it has provided a limit on **interest expenditure** which can be claimed as a deduction. This is in BEPS action reports (No. 4) which **G20 and OECD** have agreed. The details are discussed below.

15.4 The amount of interest paid on loan borrowed from a non-resident Associated Enterprise (related party) is restricted to **30%** of the Earnings before Interest, Tax, Depreciation and Amortisation or the actual amount of interest paid to the Associated Enterprise, whichever is lower. (Amortisation is spreading of expenses over more than one years). Popularly such earnings are known as **"EBITDA"**. This restriction also applies to a Permanent Establishment of a non-resident in India which pays interest to the Head Office or a group company.

There is no specific limit on interest paid to independent third parties except as mentioned in para 15.5 below.

15.5 Avoidance of Anti-Avoidance Provision:

15.5.1 S.94B is an Anti-Avoidance Provision. It restricts allowability of interest paid/ payable to a NR associated enterprise (AE).

To avoid such a restriction, parties can arrange the loan differently. The loan may be given to the Indian assessee based on or relying on:

(i) a guarantee given by the NR; or
(ii) funds provided by the AE to the lender.

Hence S.94B provides that even in such cases – where interest is not paid to NR AE, it will still be disallowed.

This is Anti-Anti-Anti Avoidance provision.

15.5.2 If say, the foreign parent company provides a **guarantee** to the foreign bank which lends funds to the Indian subsidiary, such a transaction will also be considered to a transaction with related party. Restriction on deduction of interest will apply.

Similarly if the foreign company keeps a deposit with a foreign bank which then provides the loan, similar restriction is there.

This restriction on allowability of interest expenditure is applicable only when all the following circumstances are applicable:

(i) Interest is payable by an Indian company; or by a permanent establishment of a foreign company. (Non-Corporate assessees should not bother.)

(ii) Interest payable is in excess of Rupees One Crore (presumably for the assessment year).

(iii) Interest is payable to a Non-Resident.

(iv) Interest is claimed as deductible expenditure against Indian income taxable under the head "Profits from Business or Profession".

(v) If Indian assessee is a banking or Insurance company, S.94B won't apply to it.

This is a protection from difficulties to small assessees. This provision is to prevent erosion of India's tax base. If there is no "Base Erosion"; this restriction need not be applied.

15.5.3 A healthy approach may be observed:

Normally, for allowing tax relief, there are several conditions. Under the new provisions; restrictions, will be applied only if several conditions

will be fulfilled. Further, the expenditure disallowed in one year is allowed to be carried forward.

The restriction applies to all kinds of financial arrangements – loans, financial leases, financial derivatives, etc. – which give rise to interest, discount or financial charges.

15.6 In case - interest in excess of 30% of EBITDA is disallowed, the excess can be carried forward to subsequent years and be set off against profits of those years. The total deduction (for past years' interest and current year's interest) in any case will not exceed the limit of 30%.

The excess interest can be carried forward for a maximum of 8 Assessment Years.

15.7 A concern is raised that many times a parent company provides a guarantee only to enable the subsidiary to avail of the loan. The parent company provides a guarantee to all group companies. Other than this facility, the subsidiary has to borrow at competitive rates. Interest expenditure is paid to a foreign bank which is a 3rd party. There is no inter-company transfer of income. The parent abroad does not derive any benefit/ income which gets deducted as expenditure in India. There is no base erosion due to Transfer Pricing. Even though this may be the case, all such arrangements are covered for the purpose of restriction. (see para 15.10)

15.8 What should be considered for EBITDA? Does it refer to earnings as per accounting standards or earnings as per ITA? The law does not provide for the same. The BEPS reports state that EBITDA can be as per tax law or accounting standards as the country may provide. Further it also states that incomes which are exempt from tax (like dividend) should not be considered to compute EBITDA. This is logical. If the income is exempt, the expenses pertaining to such income also cannot be allowed. By not considering such incomes for EBITDA, automatically the interest to be allowed is restricted.

No such provision is made in the Finance Bill proposal. It will be better to have clarity in the Indian rules on EBITDA.

15.9 Does it mean that restricting the deduction of interest is the only adjustment for excess interest? Consider the following:

i) The MNC holding company provides that the rate of interest will be 20% instead of the market rate of 5%. Even after charging 20% interest, the total interest is within 30% of EBITDA. Will the excess interest due to extra 15% rate of interest be disallowed? Prima facie

under the Transfer Pricing rules, the excess interest can be disallowed.

ii) If the MNC holding company provides funds in the ratio of low equity and high debt, can any adjustment be made? While Transfer Pricing rules do not provide a specific adjustment, the GAAR rules provide that high debt-equity ratio can be considered to determine whether GAAR rules should apply. (The difference between Transfer Pricing rules and GAAR is that in case of Transfer Pricing rules, the tax payer is required to suo-moto adjust the income to reflect the market price. Whereas GAAR needs to be invoked by the tax department if it considers that the arrangement is to avoid income-tax.)

iii) The DTAs provide that if interest paid is in excess of that which is normally payable between unrelated parties, then the lower rate of tax will not apply. Can this rule continue to apply? Legally, yes.

15.10 Disallowance of interest above 30% is a "**Specific Anti-Avoidance Rule (SAAR)**". Having applied the specific rule, can other avoidance rules also apply? The circular by tax department (No. 7 dated 27.1.2017) states that GAAR can apply even if there is a specific anti-avoidance rule. By this logic, other rules can also apply.

15.11 The BEPS report discusses several ways (or combination of ways) in which excess interest can be disallowed. More countries are adopting a fixed ratio rule as adopted by India in this Finance Bill. BEPS has recommended that countries may fix a ratio between 10 and 30% above which the interest will be disallowed. India has adopted a ratio of 30% - perhaps considering the higher interest rates in India compared to developed countries where the rates are much lower. The thought behind applying a fixed ratio is that it is objective and simple. It avoids other difficulties of finding the market rate of interest, debt-equity ratio etc.

15.12 Wherever S.94B applies, Income-tax assessment proceedings can be lengthy and time consuming. It will be better for the assessee to collect all necessary evidence & information at the time of filing of the return – and in any case, even before the AO serves a scrutiny assessment notice.

16. Secondary adjustment in case of Transfer Pricing [S. 92CE]:

16.1 Transfer Pricing rules provide that in case an Indian company earns less income from dealing with a related party abroad, than it would have earned from dealing with a third party, then the income can be "adjusted", i.e., the income will be increased. This is known as **"primary adjustment"**.

It may be noted that Transfer pricing rules do not require the accounts and finances to be adjusted. These may remain as they are. However for tax purposes, the taxable income will be increased. This additional income due to primary adjustment does not have to be remitted to India. The accounts do not have to be re-written.

16.2 To make further adjustment on account of funds not coming into India, the finance bill has made amendments. It provides that if the additional income is not received by the Indian entity within a reasonable time (to be specified later), then it will be considered that the Indian entity has given a loan to the foreign related party. Interest on the same can be considered for tax purposes.

This adjustment is known as "**Secondary adjustment**".

If the additional income due to primary adjustment is brought into India, no further "secondary adjustment" will be made.

This is also a fall out of BEPS Action reports on Transfer Pricing. Some countries consider such income outside India as dividend paid by the Indian entity to the foreign entity. Tax on dividend is levied. India has considered interest on loan as the secondary adjustment.

16.3 This secondary adjustment was considered by the department in the case of **Vodafone-II** case where Vodafone invested in the equity capital of its 100% Indian subsidiary. Vodafone invested at a particular price. The officer held that the market value of Indian company's share was higher. Hence more funds should have been invested in India. He considered the difference in the market value of shares and the amount invested as income. This was primary adjustment. Further, as the funds were not brought into India, the officer considered the funds which were not brought into India, as loan given by the Indian company to Vodafone. On this, interest was also assumed. This was secondary adjustment.

The High Court struck down both adjustments. The first adjustment of increase in the amount due to higher premium was struck down as share investment was a capital receipt.

The secondary adjustment of interest was also struck down as the law did not provide for secondary adjustment.

Now with the amendment in law, secondary adjustment will be possible. However, as per the wording of the provision, this will be possible only in cases where primary adjustment impacts the taxable income. Primary adjustment in case of capital receipts cannot be made as they do not impact taxable income. Therefore, a view can be taken that secondary

adjustment is not applicable in cases where primary adjustment is not possible.

16.4 The secondary adjustment has to be made from FY 2016-17.

If the secondary adjustment is **less than Rs. 1 cr.**, then no secondary adjustment will be made.

16.5 Can further adjustment (tertiary adjustment and so on) be made if the deemed interest is not brought into India? That does not seem to be the case.

The reason is that "primary adjustment" and "secondary adjustment" have been specifically defined. "Primary adjustment" means the first adjustment made in case of actual transaction as per Transfer Pricing rules which leads to an increase in total income or reduction in loss, as the case may be. "Secondary adjustment" is dependent on "Primary adjustment". If there is a primary adjustment, there can be secondary adjustment. Secondary adjustment has not been deemed to become primary adjustment.

Therefore there is no requirement of any further adjustments if interest is not remitted into India.

16.6 It may be noted that as in case of primary adjustment, the country where the related party is situated, may not allow the deduction of expense towards secondary adjustment too. (See para 16.7 below). This can lead to double taxation for the group as a whole. Any adjustment in the other country will require a Mutual Agreement Procedure. This is a time consuming and expensive process.

16.7 Compensatory Adjustment:

(i) In India & (ii) Abroad.

This is explained with an illustration.

Consider that I Co is an Indian Company. F Co is a Foreign Company & Associated to I Co.

I Co pays Rs. 100 to F Co as interest expenditure. Under S. 94B it is determined that allowable expense is only Rs. 50. Hence I Co will get a deduction of only Rs. 50.

However, F Co's income will be Rs. 100. So I Co is expected to deduct Indian Income-tax at source on Rs. 100.

If I Co's deduction is restricted to Rs. 50, will F Co's income be reduced Rs.50; and hence TDS to be reduced appropriately?

Such an adjustment is called Compensatory Adjustment within India.

If F Co's own income-tax department in the foreign country also considers the income to be reduced to Rs. 50; then that would be Compensatory Adjustment abroad.

CBDT has declared under second proviso to S. 92(C)(4) that no Compensatory Adjustment will be made within India. As far as foreign adjustment is concerned, it has to be decided by the Government of the foreign country. Indian law and DTA don't provide any procedure to facilitate Compensatory Adjustment Abroad.

17. Tax on Capital Gain on shares of a Private Company earned by a non-resident [S. 112(1)(c)(iii), Clause 43 of Finance Act 2012]:

17.1 Capital Gain earned by an NR on sale of shares are taxed slightly differently compared to Indian residents.

17.2 Finance Act 2012 provided that when an NR sells an unlisted security, it would be taxable at a concessional rate of 10%. The benefit of foreign exchange fluctuation and indexation would not be available. The definition of security will be as per Securities Contracts (Regulation) Act.

17.3 In the case of Dahiben Umedbhai Shah (57 CompCas 700) the H'ble Bombay High Court opined that definition of securities under SCRA refers to shares which can be sold in the market. In that sense, shares of a private company are not "marketable securities". Therefore, it was held that shares of private companies are not securities as defined in Securities Contracts (Regulation) Act. As this was not the Government's intention, an amendment was brought in vide Finance Act 2016 clarifying the position that the concessional rate was available for the shares of privately held companies also.

17.4 The amendment of Finance Act 2016 was applicable only from FY 2016-17 onwards. However, the rate of 10% on sale of private company's shares was applicable from FY 2012-13 onwards. This would mean that the rate would not apply for the FYs 2012-13 to 2015-16. Therefore, Finance Bill 2017 now provides that the 10% rate of tax will be available from FY 2012-13 onwards.

17.5 Thus sale of shares of private companies will be taxable @ 10% without considering inflation adjustment or foreign exchange fluctuation adjustment from FY 2012-13 onwards.

17.6 If tax at higher rate has been paid, and there is a possibility of revising the returns, then the returns should be revised. Alternatively, if the matter is open in assessments or appeals, it can be taken up there.

D. Encouraging Digital Economy; Discouraging Cash transactions:

After demonetisation, government has taken a slew of measures to promote digital economy and discourage cash transactions. Few measures have also been provided in the Finance Bill for ITA which are as follows:

18. Disallowance of Capital and Revenue Expenditure in cash [S. 35AD & 40A(3)]:

18.1 Under the current provisions of ITA, if any payment for revenue expenditure to a person in one day is in **excess of Rs. 20,000/-**; and payment is not made by account payee cheque / draft, the same is disallowed as an expense.

Similarly, disallowance also applies to expenses incurred in one year and paid in subsequent year.

Finance Bill has reduced this limit **to Rs. 10,000/-**.

18.2 It has also been clarified that apart from payment by cheque / draft, payment can be made by any electronic clearing system through a bank.

18.3 Currently under ITA, the restriction on cash expenses is only for "revenue expenses" and not "capital expenses". Revenue expenses are allowed in the year of incurring the same as they pertain to the year itself. Capital expenses result in purchase of an asset on which depreciation is available. Courts have held that the restriction on revenue expenditure does not apply to capital expenditure.

18.4 It has now been provided that if a **capital expenditure** of more than Rs. 10,000/- is not through banking system, then the entire expenditure above Rs. 10,000 will be ignored. The consequence is that depreciation will not be allowed. It can become a very heavy cost.

Similarly for some capital expenditure in case of some businesses like **storage of natural gas**, **specified hotels**, and some other businesses, the entire amount is available as a deduction (Investment-linked deduction). This deduction will not be available over and above Rs. 10,000 if expenditure is not incurred through banking system.

18.5 It should also be noted that in case of revenue expenses, the rules provide for **certain exceptional situations** where there will be no disallowance even if cash payment is above Rs. 20,000 (e.g. purchase of goods from a village where there is no banking facility). (Rule 6DD). There is no such relief for capital expenditure.

An illustration of some consequences– in case a factory is being constructed in a remote area, payment has to be made to labourers on a daily basis in cash. This payment is not revenue expenses. The entire cost of labour is a part of capital asset (factory). All such expenses will be disallowed. One can of course make a payment to a labour contractor by cheque. The labour contractor can make payment to the labourers in cash. For the labour contractor, the payment is revenue expenditure. If the payment is less than Rs. 10,000 per day per labour, it should be allowed. We are not recommending this. However people will attempt to find ways. It will be better that for capital expenditure also, appropriate relief should be available in case of bonafide difficulties.

18.6 It should also be noted that making payment in cash is not illegal. It however leads to high tax cost. In case of personal expenses, where there is no issue of any disallowance of expenses (e.g. buying personal furniture), these provisions do not apply. There are however restrictions on recipient of income. (see next para).

19. Restriction on receipt of income in cash [S. 269ST, 271DA]:

19.1 Finance Bill provides that if any recipient receives Rs. 3 lakh or more in cash, he will be penalised with an amount equal to the amount received by him.

19.2 For following transactions, a person will be liable to penal consequences if he accepts Rs. 3 lakhs or more cash:

i) **From one person in a day:**
Example: Mr. A purchases furniture worth Rs. 2 lakhs; and white goods worth Rs. 2 lakhs from Mr. B. Although both are separate transactions, Mr. B cannot accept an amount exceeding Rs. 3 lakhs in cash in one day. Whether the sale transactions are entered into in one day or over several days is not relevant.

ii) **For one transaction:**
Example: Mr. X wishes to buy a property of say Rs. 25 lakhs from Mr. Y. Mr. X proposes to pay Rs. 2.5 lakh every week to Mr. Y. However, the same will not be permitted because it is for one single transaction of purchase of property. The daily limit is not relevant.

iii) **For transactions relating to one event or occasion from one person:** **Example:** ABC Pvt. Ltd. and DEF Pvt. Ltd. are jointly organising a 2-day orientation for their employees. They have appointed XY & Co. (Partnership Firm) as event managers. Their charges are say Rs. 2 lakhs per day. Now if ABC Pvt. Ltd. and DEF Pvt. Ltd. want to pay Rs. 2 lakhs each in cash, XY and Co. cannot accept it as the payment is for one single event (the orientation course). Here, limit per person or per transaction is not relevant.

These restrictions will affect contracts of catering, marriage functions, etc. where cash transactions are frequent.

19.3 If the person can establish that there were sufficient reasons due to which he had to accept the funds in cash, then there will be no penalty.

19.4 **Note:** As usual, all penalties are for people who bring their financial transactions on record. Consider the illustration of the payer & receiver both – do not bring the cash transactions to records. They can't be penalised. And it is believed, there is a huge cash economy for which these provisions have no effect.

20. Other concerns:

There is a huge issue in USA. All digital communication transacted – whether in India, USA or elsewhere is exposed to US Government if the service provider is a US Company. Transactions carried out within India in cash are not exposed to US Government. What kind of exposure we are inviting by going digital – is a serious issue to be considered.

E. Business transactions

21. Minimum Tax and credit for Minimum Tax [S. 115JAA & 115JD]:

21.1 Minimum Alternate Tax (MAT) is payable by companies and Alternate Minimum Tax (AMT) is payable persons other than companies. Tax payable under ITA is higher of the following:

i) Tax under Normal provisions of the ITA; or
ii) Tax as per MAT/AMT provisions.

In a case where tax payable is as per MAT/AMT provisions, then the excess MAT/AMT paid over tax as per normal provisions, is available as credit in subsequent years. In subsequent years, if tax payable under normal provisions is higher than MAT/AMT, the excess MAT / AMT of earlier years can be set off against normal tax. (Please refer to our budget note for 2012 for a detailed example.)

http://www.rashminsanghvi.com/downloads/taxation/budget_notes/Finance_Bill_2012_An_Analysis.pdf

21.2 As per the current provisions, MAT/AMT credit can be carried forward up to 10 years. Finance Bill provides for increasing this time limit to 15 years.

22. Rationalisation of provisions of MAT in line with Indian Accounting Standard (Ind-AS):

22.1 Section 115JB provides for levy of MAT on book profits. Book Profits refers to profit disclosed in Statement of Profit and Loss Account prepared in accordance with the provisions of Companies Act, 2013. Companies to whom Ind-AS apply are required to bifurcate their Statement of Profit and Loss into 2 parts (Ind-AS – 1 Presentation of Financial Statements):

(i) Net profit for the year; and
(ii) Net Other Comprehensive Income (OCI)

Ind-AS promotes the concept of Fair Value Accounting. This means that all the assets and liabilities shall be valued at fair value. The present accounting system followed by companies is based on historical cost i.e., assets are valued at cost. This would require restatement of assets.

OCI includes financial impact arising from reinstatement of underlying assets in accordance with the principle of Fair Value Accounting. This results into "appreciation" or "depreciation" in the value of assets (i.e., unrealised or notional gain/loss) which needs to be accounted. Due to the concept of OCIs profits arise at two different stages– i) Profit before tax and **before OCI adjustment** and ii) Profit before tax but **after OCI adjustment**.

22.2 A concern was raised that whether OCI should be included for computing the book profits? CBDT had constituted a committee to address this concern. In consultation with Ministry of Corporate Affairs (MCA) the committee made consultations for addressing this issue. The recommendations of the committee were accepted and amendments were made for computation of book profits in different cases.

22.3 Briefly, the amendments provide that book profit for MAT purposes would include the appreciation/depreciation as per OCI. However, there are certain exceptions for items which would have an impact only on their realisation or disposal.

Further, in the first year of adoption of Ind-AS, companies would be required to adjust the opening book value of assets and liabilities. This

would result in a huge adjustment to be made through OCI which would also impact the MAT computation. To defray the huge increase in MAT, it has been provided that the transition adjustments as on the first day of the reporting under Ind-AS must be considered equally over 5 years from the first year.

22.4 It is advisable that companies which have to adopt Ind-AS should take proper advice on applicability and impact of MAT on their tax liability.

23. Real Estate Joint Development Agreement (JDA) [S. 45(5A), 49(7) & 194-IC]:

23.1 Real estate projects happen in various manners. One of the usual manner is where Land owner and Builder / Developer come together to develop real estate property. Typically it is referred to as Joint Development Agreement (JDA). In a JDA, the owner of immovable property (land or building or both) provides "Development Rights" (DRs) to the developer. For these DRs, the owner is paid consideration by way of cash or share in the new immovable property or a combination.

The property is not transferred / sold. Ownership remains with the owner. The Developer develops new property on the existing property. Ownership of existing property may be transferred when the new property is developed.

Under the current provisions, capital gains tax is triggered in the hands of land owner at the time when the **possession of existing property is handed over for development.** This creates difficulty for the owner of the property as consideration would not have been realised when possession is given. Consideration will be received when the new property is ultimately sold.

23.2 Therefore, in order to minimise the hardships faced by owner of immovable property, Finance Bill provides for the following:

23.2.1 Capital gains earned by the owner in a JDA will be taxed only in the year in which **Certificate of Completion for the project (i.e. new property) is issued** by the competent authority. It is clarified that even if completion certificate is issued for part of the project, it will be sufficient to trigger the tax.

In this situation also, the owner would not receive cash. But then he will have to generate cash by selling the new property.

23.2.2 **Sale consideration** will be taken as the stamp duty value of owner's share in the project on the date of Certificate of Completion. Any monetary

consideration received on transfer will also be included in sale consideration.

23.2.3 If however the owner transfers his share in the project on or before the date of issue of Certificate of Completion, Capital gains will be taxed in the year of transfer of the project. This could trigger even in transfer of a part of the project.

23.3 The owner will acquire share in the new property against the old property. The new property is the consideration for old property. Cost of share in the new property will be the sales consideration considered for transfer of old property (see para 23.2.2).

23.4 **TDS** – If the property owner receives any monetary consideration under the JDA, the payer will have to deduct tax at source @ 10%. There is no TDS on paying consideration by way of share in the new property.

23.5 This section is applicable to **individuals and HUFs only**. Thus for other persons, existing provisions continue to apply, i.e., in case of other persons, capital gain tax is payable when the land is handed over for development to the builder.

23.6 There can be some technical difficulties. A person can hold property as "Capital asset" or "Stock in trade". Sale of capital asset gives rise to Capital gain / loss. Tax rate is lower for Capital gain. But if the person holds the property as stock in trade, sale generates business income / loss. Tax rate is higher.

If the land owner enters into a JDA, it means he is converting the Capital asset (immovable property) into Stock in trade. When a person enters into a JDA, it means he is going to undertake business with his immovable property. This conversion happens just before he hands over the possession.

If the property is stock in trade, then whether this relief will be available or not, is debatable.

24. Restriction on set off of loss against income of units in Special Economic Zones [S. 10AA]:

24.1 Under ITA, if any person is undertaking business in SEZ, profits related to exports of the SEZ undertaking are exempt from payment of Income-tax. The relief applies to the income of the "unit" in the SEZ.

24.2 In many cases, companies have units in SEZ as well as in areas outside SEZ (Non-SEZ units). Tax payer is one. Business units are two or

more. Relief for profit of SEZ unit is available as per the provisions of S. 10AA. Losses if any of other units are carried forward.

24.2.1 The issue is – Can the loss be carried forward without setting it off against the income of SEZ unit? This results in higher losses being carried forward and being set off against taxable income of subsequent years.

24.2.2 The tax department is of the view that exemption is available only after setting off of losses of non-SEZ units. A circular (No. 7 of 2013) was also issued stating the view of tax authorities. The courts have taken a view in favour of assessee providing exemption for entire income of the SEZ unit, i.e., the losses of Non-SEZ can be carried forward.

24.3 Finance Bill provides to clarify that deduction for profits of SEZ units will be provided only on the net income after setting off of losses and not for the entire income of individual SEZ unit.

Refer to Example 4.

Example 4:
An Indian company has total 3 units – Unit 1 in SEZ and Units 2 and 3 outside SEZ (non-SEZ units). The profits/(losses) of SEZ undertaking is Rs. 250 and of non-SEZ units are (Rs. 450) and Rs. 300.

An evaluation of taxable income in the scenario before clarification and after clarification is explained below.

Scenario I – Before Finance Bill 2017

Sr. No.	Particulars	Amount (Rs.)
1	Unit 1 – SEZ	250
2	**Less:** Deduction u/s 10AA	(250)
3	Unit 2 – Non-SEZ	(450)
4	Unit 3 – Non-SEZ	300
5	**Total taxable income (1+2+3+4)**	**(150)**
6	**Losses to be carried forward**	**(150)**

Scenario II – After Finance Bill 2017

Sr. No.	Particulars	Amount (Rs.)
1	Unit 1 – SEZ	250
2	Unit 2 – Non-SEZ	(450)
3	Unit 3 – Non-SEZ	300
4	**Less:** Deduction u/s 10AA - restricted to	(100)
5	**Total taxable income (1+2+3+4)**	**NIL**
6	**Losses to be carried forward**	**NIL**

This will result in higher tax burden for the tax payer in future years.

25. Domestic Transfer Pricing [S. 40A(2)(b), 92BA]:

25.1 Domestic Transfer Pricing provisions were introduced by Finance Act, 2012 based on the decision of **Supreme Court** in the case of **Glaxo Smithkline Asia (P.) Ltd.** Briefly, the Honourable Supreme Court in this decision had addressed a larger issue of whether Transfer Pricing provisions should be extended to domestic transactions. It mentioned that shifting of profits in such transactions, being domestic, would ordinarily be tax neutral. However, this would not be the case where one of the companies is making a loss (resulting in tax arbitrage); or if different tax rates are applicable to the assesses concerned. The Honourable **Supreme Court had recommended empowering the assessing officer** to apply any of the generally accepted methods to determine the Arm's Length Price (ALP) in respect of such transactions. Further, it recommended maintenance of books of accounts and documents in such cases; as also obtaining of an audit report from a Chartered Accountant.

25.2 The transfer pricing provisions apply to specified domestic transactions. The specified domestic transactions are:

- Payments to related parties u/s. 40A(2)(b), and
- Where one party enjoys any kind of profit linked tax incentives. Eg: deduction under S. 80IA.

The transfer pricing provisions apply only if aggregate transaction value exceeds Rs. 20 Crores.

25.3 These provisions increased the compliance cost in case of small businesses and burden of the tax payers considerably. Further it caused difficulties in case of transactions like managerial remuneration. It was difficult to find comparable transactions.

In order to reduce the compliance burden the Finance Bill proposes to exclude the payments made to related parties from the meaning of specified domestic transaction. [S. 92BA] Transactions where one party enjoys a tax holiday or deduction/exemption, still continue to be covered by the Domestic Transfer Pricing provisions.

This is a beneficial provision and reduces the compliance burden to a large extent where tax arbitrage was anyways to a minimal extent.

26. Increase in limits for maintenance books of accounts [S. 44AA]:

Every person carrying business or profession (other than specified professional) are required to maintain books of accounts if turnover or income exceeds the limits specified in the Act. In order to reduce the compliance burden, these limits have now been increased for **Individuals and HUFs**. The proposed changes are summarised in the table below:

Particulars	Current limit	Proposed limit
For income	1.20 lakhs	2.50 lakhs
For turnover/sales/gross receipts	10 lakhs	25 lakhs

27. Increase in limit for audit for businessmen opting for presumptive taxation scheme [S. 44AB]:

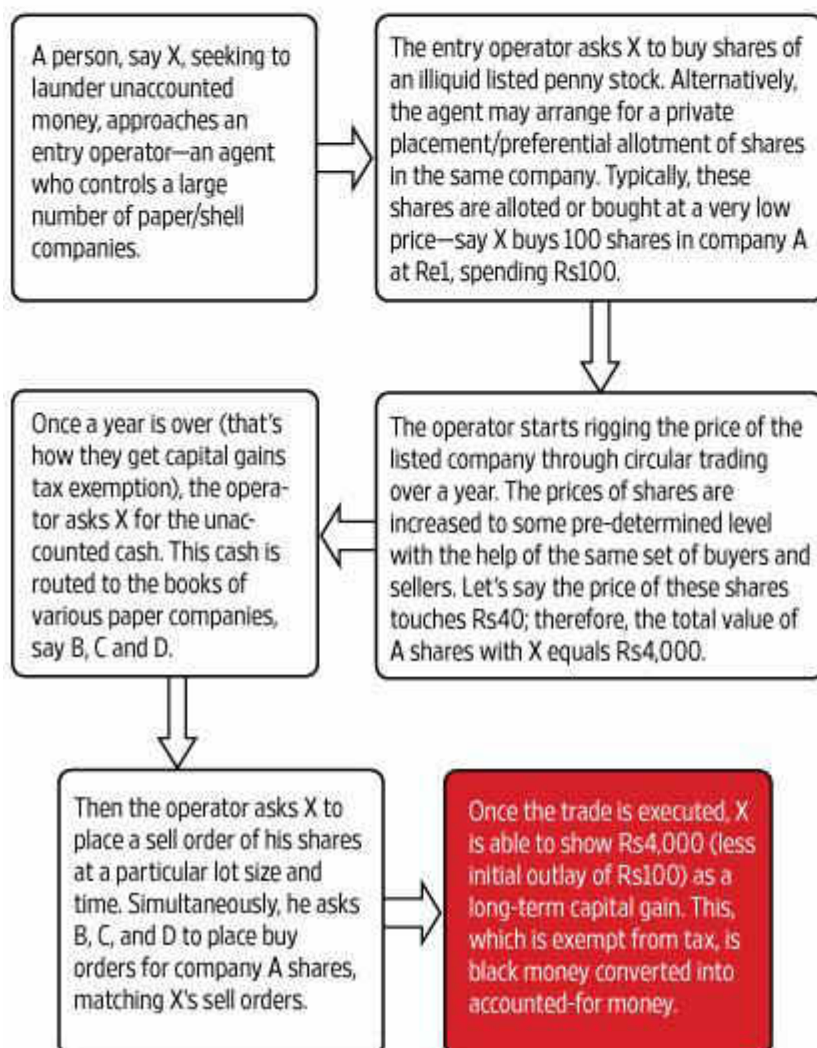
The Finance Act, 2016 had increased the limit of turnover for businessmen opting for presumptive taxation scheme from Rs. 1 crore to Rs. 2 crore. However, corresponding amendment was not made in the limit for audit of books of accounts (S. 44AB). This issue was mentioned in our Budget note for 2016 in para 19.2.4. It was clarified vide CBDT press release dated 20th June, 2016.

Now an eligible person opting for presumptive taxation scheme as per S. 44AD(1) shall not be required to get his accounts audited if the total turnover or gross receipts of does not exceed Rs. 2 crore.

F. Specific Anti-Avoidance Measures

28. Anti-avoidance rule for Penny Stock scams [Section 10(38)]:

28.1 In the recent past, there have been multiple penny stock scams whereby black money was routed through sale of shares on stock exchange to create white money. This was helped by the fact that Long Term Capital Gain on shares sold on stock exchange are exempt from tax. Instead, Securities Transactions Tax (STT). Each party to the transaction – purchaser and seller pay STT. There is no condition that the seller should have purchased the shares on the stock exchange and should have paid STT. The modus operandi is as follows:



Source: LiveMint.com:
http://www.livemint.com/Money/K7ZShkwxTNahd1v5pHT9HK/Penny-stocks-scam-Stockbrokers-turned-a-blind-eye-to-KYC-no.html

28.2 The Finance Bill 2017 proposes a proviso to the above provision whereby the exemption will be allowed only if the purchase also happens over the stock exchange. Therefore, both purchase and sale legs of the transaction are to happen over the stock exchange. This is a Special Anti-Avoidance Rule (SAAR).

28.3 The exemption for Long Term Capital Gain was brought in to effect from 1st October 2004 by introducing STT in place of a tax on capital gains. Therefore, this proposed restriction is also applicable only for shares purchased after 1st October 2004.

28.4 Further, there would be genuine transactions where shares are not purchased on the stock exchange. In such cases, the exemption would still be available. For example, shares purchased on IPO or FPO, through FDI, attained as bonus or rights issue, etc. Further, there would be transfers which would not be subject to STT like mergers and demergers. The Government will notify a list of such purchases and transfers.

28.5 While the intention seems to cover large scale laundering which was taking place, the provision may not be effective. This is because, the provision aims to only remove the exemption for sale of shares which were not listed when they were purchased. However, there can be instances of similar transactions using shares of listed shell companies. These would not get covered under the proviso. Further, those who have purchased such unlisted shares which have later on got enlisted on a stock exchange, would easily circumvent the provision by selling the shares and buying them back on the stock exchange before 31st March 2017. The Government as per its promise has not carried out any retrospective amendment.

28.6 In any case, the effect of the transaction is that the exemption from tax would be lost for such transfers. It does not penalise the launderers or disallow such transfers at all. Therefore, the laundering process will now be liable to tax on sale of such shares, but such transfers would not be restricted. Separately, the Government is working on weeding out such transfers, finding out the perpetrators and marking out those companies which are being used for such laundering schemes.

28.7 The list of transactions that will not be covered by this proviso is yet to be prescribed by the Government. It should ideally cover all genuine transactions of purchase of shares without payment of STT.

28.8 It may be noted that this amendment is only for Long Term Capital Gain. It is not for Short Term Capital Gain. The modus operandi to convert black money into white can be applied in case of Short Term Gain also. However Short Term Gain is chargeable to tax at 15% instead of 30%. The saving of 15% tax is perhaps not worth the effort!

29. Tax on receipt of money and certain specified assets without consideration or for insufficient consideration [Section 56(2)(x)]:

29.1 Over the past few years, provisions have been introduced in the Income-tax Act to tax receipts of sums of money and certain other properties which were received without consideration or for insufficient consideration. These provisions were introduced to counter laundering of black money. There is a threshold of Rs. 50,000. Exemption is provided for amounts or properties received from relatives, on marriage, under a will, etc.

The position presently is that **individuals and HUFs** are taxed in such situations on receipt of sums of money, immovable property, jewellery, bullion, art, shares and securities, etc., without consideration or for insufficient consideration. Further, **firms and private companies** are taxed on receipt of shares of another private company without consideration or at a value lesser than the fair market value.

29.2 The fair market value of immovable property, shares and other assets is as prescribed in the Rules.

29.3 The Finance Bill 2017 proposes make the following changes:

29.3.1 The provisions now target all persons. This will hence now include public listed companies, AOPs and BOIs apart from individuals, HUFs firms and companies which were already covered under the existing provisions.

29.3.2 Further, any person will be liable to tax on receipt of sum of money, immovable property and other specified properties mentioned above. Therefore, while firms and private companies are presently liable to tax only in respect of shares; now firms, companies, and other persons would be liable to tax on receipt of **all specified properties**.

29.3.3 A few examples of transactions that will now get covered are:

- A partner contributing immovable property in the firm as his capital. The normal provision is that whatever value is recorded in the accounts of the firm, is the sale value. If the partners record the transaction at say cost of property, there will be no tax. However the firm will be liable to tax on the difference between fair value and what is recorded in the accounts.;

- A public listed company receiving any of the specified properties without consideration or for insufficient consideration;

- An AOP receiving immovable property from one of the members for a value which is lesser than that prescribed as per the provision; etc.

29.3.4 Some transactions such as receipt from a relative or charitable trust are exempt from this section. Following further exemptions have been provided:

- Receipts by charitable trusts and institutions;
- Receipt of assets on partition of HUF;
- Receipt of shares on certain corporate mergers and demergers which are exempt from tax under Section 47.

29.4 It may be noted that only specified "capital assets" are covered by this provision. Stock-in-trade is not covered.

Further, the provision applies to specified properties. All properties are not covered by this provision. For example, receipt of "share in a LLP", intellectual property and knowhow are not covered by this provision.

29.5 While the provisions are meant to tax transfers between persons, the practical fallout is that genuine transactions not involving laundering of black money also get covered. Further, the provisions act as barriers limiting the price at which properties are transferred between two non-related entities. Therefore, all persons should now be careful while transferring any properties covered by this provision.

G Capital gain:

30. Reduction in the time period for holding of Immovable Property for Long Term Capital Gain [S. 2(42A)]:

30.1 As per the current provisions, if any immovable property, being land or building or both, is held for more than 36 months, it is considered as long-term capital asset. Capital gain on sale is considered as Long Term Capital Gain. Tax rate is lower on such gain. Other reliefs like inflation adjustment and relief for investment in bonds / house property is available to further reduce the tax.

30.2 Finance Bill provides that if any immovable property is held for more than **24 months**, it will be considered as long-term capital asset. This is a welcome relief to taxpayers owning land and building. .

31. Consideration for sale of unquoted shares at lesser than fair market value [Sec 50CA]:

31.1 At present, section 50D of the Act provides for considering 'fair market value' of a capital asset as the full value of consideration accruing on transfer **where the consideration is not ascertainable or determinable**.

31.2 However, where there is an ascertainable consideration, it is considered for Capital Gain. There is no requirement to see whether the sale is at fair value. Thus people can receive the consideration partly by cheque and partly by cash and avoid tax. For transfers of immovable property Section 50C provides that the stamp duty value to be the minimum value of consideration. There is no such provision for other assets.

31.3 The Finance Bill 2017 proposes a new Section 50CA which prescribes that where the sale consideration for unquoted shares is lower than the fair

market value, the fair market value will be considered as the full value of consideration.

31.4 The fair market value will be as prescribed by the Government. At present, there is a fair market value prescribed for unquoted shares under Rule 11UA. However, these values are prescribed for different purposes (e,g, gift). We need to see if the Government continues with the same formula or adopts a different one for Section 50CA.

31.5 Further, Section 50CA provides for a definition of quoted shares as follows:

> "A share quoted on any recognised stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business."

All shares other than quoted shares as defined above would be covered under the provision of Section 50CA. Therefore, it should be noted that even listed shares where transactions are not happening frequently will be termed as unquoted shares. There is no objective criteria for determining regularity of such transactions and decision of what constitutes unquoted shares may lie at the discretion of the tax officer.

31.6 It should be noted that while this provision sets the minimum sales consideration taxable in the hands of the seller, Section 56 provides for the minimum value that will be taxable in the hands of the receiver. This can create taxation of the same amount in both the hands of the seller and the buyer.

Example 5:

Say Mr. A sells 100 shares of Co. XYZ, a private company, to Mr. B. The shares are transferred at a consideration of Rs. 10 per share. However, the fair market value of such shares is Rs. 2,000. Therefore, the difference between sales consideration and fair market value will be taxed in the following manner:

Mr. A, the transferor, will be taxed under Section 50CA on the difference of Rs. 199,000 (Rs. 2,000 less Rs. 10, i.e., Rs. 1990 x 100 shares).

Mr. B, the transferee, will be taxed under Section 56(2)(x) (proposed in Finance Bill 2017 and covered in para 31.3) again on the difference of Rs. 199,000 as he has received the shares at a value lesser than the fair market value.

While for Mr. B, the cost of shares will be jacked up to Rs. 2,000 per share (for subsequent sale); Mr. A will suffer a tax even though he has received monetary value of only Rs. 10 per share. While there is double tax, the taxability is on two different tax payers with the assumption that both have received an undue benefit which has now been made liable to tax.

32. Conversion of Preference Shares into Equity Shares [S. 2(42A), 47(xb) & 49(2AE)]:

32.1 Capital Gains tax is levied on any transaction involving a "transfer". A "transfer" includes not only sale but also includes exchange, extinguishment, etc. Thus consideration for transfer may be in cash or kind. When preference shares are converted into equity shares, there is an exchange of assets (preference shares are exchanged into equity shares).

There is relief available for conversion of debentures into shares. No capital gain tax is charged. There was no such relief in case of preference shares. Representations have been made to consider preference shares on par with debentures.

32.2 Finance Bill now provides that when a preference share of a company is converted into equity share of the same company, it will not attract Capital Gains tax.

32.3 As a corollary, when the equity share (converted from preference share) is sold, the period of holding of equity share will commence from the date of acquiring the preference share. The cost at which preference shares were acquired will be taken as cost of equity shares [S. 49(2AE)].

33. Shifting of base year from 1981 to 2001 for Computation of Capital Gains [S. 48 & 55]:

33.1 As per the current provisions, in computation of Capital Gains, the cost of an asset acquired before 1st April 1981, can be taken at actual cost, or the fair market value as on 1st April 1981, at the option of the assessee (i.e. whichever is more beneficial to the assessee).

33.2 The base year of 1981 is more than 3 decades old. Practical difficulties are faced by people to obtain Fair Market Value as on 1st April 1981.

Finance Bill has shifted the date to 1.4.2001. Thus the cost of an asset acquired before 1st April 2001, can be taken at actual cost, or the fair market value as on 1st April 2001, at the option of the assessee.

34. Consolidation of plans within a scheme of Mutual Fund [S. 2(42A), 47(xix) & 49]:

34.1 As stated in para 32.1, any exchange or conversion of a capital asset is liable for capital gain tax. In case of Mutual Fund (MF), Finance Act 2016 had provided that consolidation of plans of mutual funds will not be chargeable to tax. However, corresponding provisions of period of holding the unit of MF and cost of acquisition were not amended.

34.2 Finance Bill therefore provides the following:

i) Period of holding the units of consolidated plan of MF scheme will be considered from the date of acquiring the units before consolidation.

ii) Cost of acquiring units will be the original cost of purchase of units.

This amendment will be effective from FY 2017-18 onwards. However, the main provision exempting such transfers came in to force from last year, i.e., FY 2016-17. It seems to be a lacunae and the Finance Act should ideally correct the date of applicability of this provision.

35. Expanding the list of long-term bonds for Capital Gain tax relief [S. 54EC]:

35.1 To provide relief from tax on long-term capital gain, a deduction up to Rs. 50 lakhs is available, if bonds of REC or NHAI are purchased within 6 months from the date of transfer.

35.2 At present, investments in NHAI or REC Bonds are the only eligible bonds for claiming the relief. Finance Bill provides that investment in any bond redeemable after 3 years and which will be notified by the Central Government, will also be eligible for deduction. Thus more bonds will be notified for the relief.

H. Other changes:

36. Advance tax related amendments:

36.1 Advance tax instalment for professionals [S. 211]:

36.1.1 Finance Act 2016 introduced presumptive taxation scheme for certain professionals. Under this scheme, if a professional person has a turnover of upto Rs. 50 lakhs, 50% of gross receipts of professionals are presumed to be their income and tax has to be paid on it accordingly. Presumptive tax is already in place for small and medium businesses for past few years.

36.1.2 For payment of advance tax under presumptive tax scheme, persons having business are required to pay the entire advance tax in only one instalment – on or before 15th March of financial year. However, for presumptive tax scheme applicable to professionals, tax was required to be paid in 4 instalments - on 15th July, 15th September, 15th December and 15th March.

36.1.3 To bring parity in treatment, professionals are now required to pay entire advance tax in only one instalment – on or before 15th March of the financial year.

36.1.4 This amendment is applicable from FY 2016-17. Some professionals may not have paid advance tax till now for FY 2016-17. Now with this amendment, interest for short payment of advance tax for first 3 quarters of FY 2016-17 for such professionals will not be charged. However, these professionals are required to pay entire advance tax on or before 15th March 2017 (for FY 2016-17).

36.2 Advance tax on domestic dividends [S. 234C]:

36.2.1 Finance Act 2016 introduced tax on dividends above Rs. 10 lakhs for individuals, HUF and a firm (S. 115BBDA). The dividend has to be considered in computing advance-tax to be paid.

36.2.2 However, one never knows when the company may declare dividend. Normally dividend is declared at the Annual General Meeting which may happen in August. At times interim dividend is also paid which can be in any month. Further, one cannot know how much will be the dividend, or whether it will be declared at all. Therefore, due to uncertainty of dividend declaration, difficulty may arise in determining the advance tax liability in relation to that income. For example, if the company declares dividend in December, there will be a default of advance tax for June and September quarter. This can lead to interest liability on shortfall of advance tax payments.

36.2.3 Finance Bill provides that no interest will be levied in the quarter for shortfall in advance tax, if dividend has not been declared in that quarter. However, advance tax has to be paid in the subsequent quarters.

This provision is applicable from FY 2016-17 itself.

37. Taxation of dividend [S. 115BBDA]:

37.1 Dividend paid by companies is normally exempt from taxation. Finance Act 2016 provided that dividend earned above Rs. 10,00,000 by a

resident individual, HUF or a firm is taxable at the rate of 10%. Non-residents and other persons were exempt from this tax.

37.2 Finance Bill 2017 proposes to extend the applicability of this section to all types of resident assessees. However following persons continue to be exempt completely:

i) a domestic company; or
ii) a fund, an institution, a trust, which undertakes activities like education, medical, hospital etc. [S. 10(23C)]; or
iii) a charitable trust or institution registered with tax department [S. 12AA]

38. Deduction of tax at source from rent payments in case of Individuals and HUFs [S.194-I]:

38.1 Individuals and HUFs who are liable to tax audit u/s. 44AB are required to deduct tax at source on rent u/s. 194-I. However assessees who were not liable to tax audit were not required to withhold this tax.

38.2 Finance Act 2017 proposes to widen the scope of deduction of tax at source. Therefore, individuals and HUFs paying rent exceeding Rs. 50,000 for a month or part thereof are required to deduct tax at source @ 5%.

38.3 Such tax shall be required to be deducted at the time of payment of rent for the last month of the previous year or last month of tenancy if property is vacated during the year.

38.4 If the lessor does not have a Permanent Account Number (PAN) then tax shall be withheld @ 20% as per Section 206AA. However, the amount of tax to be withheld shall not exceed the amount of rent payable for the last month of the previous year or the last month of the tenancy.

38.5 Further, for the purposes of deducting tax at source such individuals will not be required to obtain Tax deduction Account Number (TAN).

39. Restriction on set-off of loss from house property [S. 71]:

Presently, Section 24 allowed expenses to be claimed against income from let-out property without any limit. This could result in losses under the head "Income from House Property". Further, loss under income from house property is allowed to be set off u/s. 71 during the same year against income earned under other heads. Due to high interest costs, there could be significant losses under the head "Income from House Property" which would bring down the total taxable income.

Finance Bill proposes to restrict the set-off of loss incurred from House Property against income under other heads to the extent of Rs. 2 lakhs.

Example 6:
An Indian resident earns income from following sources in FY 2017-18:

Source	Amount
Income from Salary	50,00,000
Income from House Property	(10,00,000)
Income from Other Sources	5,00,000

How much House Property loss can be set-off during the year and how much loss can be carried forward?

Source	Amount	Amount
Income from Salary		50,00,000
Income from House Property	(10,00,000)	
Less: Restricted to (S. 71)…		(2,00,000)
Income from Other Sources		5,00,000
Gross Total Income		**53,00,000**

The balance house property loss of Rs. 8,00,000 can be carried forward for 8 years as per S. 79.

40. Rates of Income tax:

40.1 Corporate Tax Rates:

In the 2015 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 had made a beginning last year by lowering the tax rate to 29% for new companies which declare not to avail any deductions or exemptions.

In this year's Finance Bill, rate of tax in case of domestic companies has been reduced from 30% to 25% provided total turnover or gross receipts of the company do not exceed Rs. 50 crores for FY 2015-16.

A similar provision was introduced in Finance Act, 2016. However, the provision of Finance Act, 2016 was applicable only to domestic companies incorporated on or after 1st March 2016. Furthermore, there are certain conditions like companies should not claim investment linked deductions, set-off any losses, etc. Also once this option is selected it cannot be subsequently withdrawn for any of the years.

After introduction of amendment by this year's Finance Bill, it seems that companies incorporated on or after 1st March 2016 and having a turnover of less than Rs. 50 Crores would not like to claim this benefit. Since this year's amendment does not enforce any other condition other than turnover limit, companies fulfilling these conditions would pay tax for AY 2017-18 at 29% or 30% as applicable.

The rate of 29% introduced last year for corporates with turnover/ gross receipts of Rs. 5 crores and less in FY 2014-15 is now replaced by the above provision.

40.2 Tax Rates for Individuals and HUF:

40.2.1 In case of every Individual and HUF rates of tax for Financial Year 2017-18 are proposed as under:

Person	Income Limits (Rs.)	Tax Rate (excluding education cess and surcharge)
Individual, HUF	0 – 2,50,000	Nil
	2,50,001 – 5,00,000	5%
	5,00,001 – 10,00,000	20%
	10,00,001 & above	30%

There has been a reduction in lowest slab rate from 10% to 5%. Tax payers shall get a maximum benefit of Rs. 12,500 across all levels of income. However, in order to provide the beneficial rate at the lowest slab, it is proposed by the Finance Bill to levy surcharge for certain tax payers. (See para 40.2.2 below)

40.2.2 As stated above in para 40.2.1, a new surcharge shall be levied in case of individuals earning total income over Rs. 50,00,000. The slab for levy of surcharge is as under:

Person	Income Limits (Rs.)	Rate of Surcharge
Individual, HUF	50,00,001 – 1,00,00,000	10%
	1,00,00,001 & above as presently applicable	15%

40.2.3 Marginal relief shall be granted in appropriate cases where income exceeds Rs. 50,00,000 or Rs. 1,00,00,000. Therefore, for tax payers earning above Rs. 50,00,000 total tax outgo may increase even after reduction in tax rate by 5% in the first slab.

40.3 Tax Rates for Foreign Companies, AOP/BOI, Firms, etc.:

There is no change in the income tax rates for foreign companies, AOP/BOI, firms, co-operative societies and local authorities.

40.4 Rebate:

Finance Act, 2013 introduced rebate u/s. 87A for individuals whose total income did not exceed Rs. 5,00,000. The rebate amount upto FY 2015-16 was 100% of tax or Rs. 2,000 whichever is lower. With a view to provide relief to small tax payers the limit of Rs. 2,000 was increased to Rs. 5,000/- by Finance Act, 2016.

The tax rates for individuals earning income between Rs. 2,50,000 and Rs. 5,00,000 is proposed to be reduced by 5% as mentioned above. As the tax payable will be reduced, the Finance Bill 2017 proposes to reduce the maximum rebate amount also to Rs. 2,500. The rebate shall now be lower of 100% of tax payable or Rs. 2,500.

40.5 The tax rates for each type of person for FY 2017-18 are given below:

Person	Income limits (Rs.)	Tax rate (basic rate; surcharge; cess)
Resident - Individual, HUF, AOP, BOI, Artificial juridical person	Upto Rs. 50 Lakhs	Maximum rate 30.9% (30%; 0%; 3%)
	50,00,001 – 1,00,00,000	Maximum rate 33.99% (30%; 10%; 3%)
	Above Rs. 1 crore	Maximum rate 35.54% (30%; 15%; 3%)
Non-resident - Individual, HUF, AOP, BOI, Artificial juridical person	Upto Rs. 50 Lakhs	Maximum rate 30.9% (30%; 0%; 3%)
	50,00,001 – 1,00,00,000	Maximum rate 33.99% (30%; 10%; 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%)

Person	Income limits (Rs.)	Tax rate (basic rate; surcharge; cess)
Indian company (Turnover or gross receipts do not exceed Rs. 50 crores in FY 2015-16)	Upto Rs. 1 crore	25.75% (25%; 0%; 3%)
	Above Rs. 1 crore and upto Rs. 10 crores	27.55% (25%; 7%; 3%)
	Above Rs. 10 crores	28.84% (25%; 12%; 3%)
Indian company (Turnover or gross receipts exceed Rs. 50 crores in FY 2015-16)	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%)
Indian company (Section 115BA)	Upto Rs. 1 Crore	25.75% (25%; 0%; 3%)
	Above Rs. 1 crore and upto Rs. 10 crores	27.55% (25%; 7%; 3%)
	Above Rs. 10 crores	28.84% (25%; 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%)

Rashmin Sanghvi & Associates
Chartered Accountants
220, 2nd floor, Arun Chambers, Tardeo Road, Mumbai - 400 034, India.
Tel. :(+91 22) 2351 1878, 2352 5694 Fax: 2351 5275
Website: www.rashminsanghvi.com E-mail: rashmin@rashminsanghvi.com