FICCI

PRE-BUDGET MEMORANDUM 2017-18

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PREAMBLE

The crisis of confidence that plagued the Indian tax system until recently has passed, and full credit for this must go to the Government. It was only a few years ago that tax issues were foremost on the minds of investors, both domestic and international, and confidence in the Indian economy itself was being shaken by developments in the tax space.

This is no longer the case today. We have seen several positive measures, both through legislative changes and through administrative action that have helped reduce uncertainty and address some key long-standing issues. Engagement with taxpayers has improved, and attitudes and perceptions on both sides have begun changing, albeit gradually. Though several controversial issues still remain to be addressed, the efforts of the Government in the tax space certainly deserve to be commended.

These naturally lead to increased expectations, and also set the stage for long-term systemic reforms that will usher in stability, certainty and predictability in the Indian regime. The forthcoming budget offers the Government the perfect opportunity to kick-start this process.

There are several provisions in the law, which need to be revisited and revised in order to make them more certain, taxpayer friendly and effective. These are discussed in detail in the enclosed Memorandum, which we submit for your kind consideration.

Changing specific statutory provisions may be the easier part of undertaking tax reform. This will however prove inadequate unless we address certain fundamental issues surrounding how we conceptualize, legislate and enforce tax law. We have taken the liberty of setting out our thoughts on some of these aspects in the ensuing paragraphs.

1.1. From Simplification to Sophistication

If one looks at tax law today and surveys the litigation arising out of it, three broad trends stand out. First, there are several provisions that are drafted in a manner that leads to uncertainty as to their exact scope and applicability. This leads to field officials taking divergent approaches, and the Courts being called upon to adjudicate what are essentially policy questions. Two examples from the Income-tax Act will help illustrate this point; the scope of section 56(2)(viia) remains uncertain, especially as regards its applicability to conversions, rights issues, buybacks etc.; similarly, the scope of section 2(24)(xviii) (dealing with subsidies) is extremely open ended, and could potentially lead to a tax on any benefit that arises from anything done by Governments and local authorities to support businesses.

Second, there are several important issues that are not addressed in the law at all. This leads to uncertainty, as taxpayers, tax officials and the Courts struggle to apply the law to situations that it never intended to address. Examples include depreciation on finance leases, attribution to permanent establishments etc.

Third, one notices that there are several provisions in the law that have little economic or policy justification. For instance, permitting carry forward of losses only in case of amalgamation of companies that own ‘industrial undertakings’ is unnecessarily restrictive, that too in an economy that is dominated by the service sector. A corollary to this is that fine print often does not sub-serve the underlying policy objectives. A simple example relates to the Circular issued to clarify the treatment of gains from sale of unlisted shares. This was intended to put to rest disputes on the subject, but this inexplicably excludes cases where the sale of shares leads to a change in management and control. As a result, this may not achieve its intended purpose of putting an end to litigation. Similar issues exist in relation to taxability offshore funds, AOPs, investment allowance under section 32AC and others.

In essence, this highlights the fact that our tax laws need to keep pace with our sophisticated, growing economy. In other words, our sophisticated, growing economy needs a sophisticated and indeed, much more comprehensive tax code. We can no longer legislate in broad generic strokes and leave it to the Courts and the field officials to do the rest.

1.2. Timely Public Consultation

Another key feature of our regime is the near absence of public consultation and debate prior to enactment of law. This is compounded by the fact that guidelines and rules take time to evolve, and are often put in place much after the legislation has come into force.

For example, in the context of the Place of Effective Management test, the final guidelines and transitory provisions are yet to be released despite the law having come into force from 1 April 2017. Similarly, the amendments relating to indirect transfers came into force on 1 April 2015, but the valuation guidelines were notified only in June 2016. To some extent, this may be due to delays in the public consultation process on the guidelines post enactment, but there is no reason why this process cannot be undertaken before the law itself is brought into force. This will go a long way in highlighting policy gaps that need to be addressed in the law and will help in the evolution of a sophisticated tax code.

1.3. Bridging the Trust deficit

Subjectivity is inherent in tax law around the world. For instance, the United States has had a substance over form doctrine in place for decades, several countries have General Anti-Avoidance Rules, and corporate residency tests based on highly fact specific subjective factors have long existed globally. Yet, when these are sought to be introduced in an Indian context, there is widespread fear and consternation among taxpayers.

This essentially arises due to a trust deficit between the taxpayers and the tax administration. As a result, subjectivity in the law leads to fear of arbitrariness in enforcement. Bridging this deficit will be the single most important aspect of tax reform in India. This will also be the single most difficult aspect of tax reform, since this cannot be done through legislative or administrative diktat. This needs a mindset change i.e. by taxpayers gaining confidence in the way tax law is administered and enforced, and by tax administrators adopting a trust-based, rather than an adversarial approach towards taxpayers. As FICCI has often stated, an undue focus on meeting revenue targets is the biggest obstacle in this regard.

Rationalizing the arrest provisions in indirect taxes is another area which will go a long way in bridging this deficit. Today, the threat of arrest, even in cases of genuine interpretational disputes, is brandished to induce taxpayers to deposit tax pending the adjudication process. This will need to be addressed on a priority footing.

Another important aspect that exacerbates this issue is the divergence in the interest rates charged and paid by the Government on tax dues. In Income-tax, interest is charged by the Government at 12%, while it pays only 6% on refunds (which is increased to 9% in certain cases of delayed refunds). In the context of indirect taxes, the Government charges 15% while paying only 6% on refunds. The dichotomy between what is charged and what is paid out is untenable. In any event, there ought to be consistency between direct and indirect tax laws on this point.

We, at FICCI, look forward to closely working with the Government in this journey and are committed to provide all possible support in this regard.

ECONOMIC OVERVIEW

2.1. Current State of Economy

2016 has been a challenging year for the global economy. The assessments made at beginning of the year, which indicated some likelihood of an improvement, were revised over time - inclining towards a weaker scenario amidst persisting headwinds.

The Global Economic Prospects report released by the World Bank in June 2016 revised the global economic growth forecast for 2016 to 2.4% from 2.9% projection made in January 2016.

The advanced economies continued to witness disparities in the pace of recovery. Further, with United Kingdom making the unprecedented move to exit the European Union, chances of an another bout of volatility remain on the anvil.

The prospects for Emerging Markets and Developing Economies (EMDEs) also remain subdued given the general sense of weakness in the global environment and typical / structural conditions marring the domestic front.

Merchandise trade flows have been strained reflecting weak demand conditions. The industrial activity in China has faced a significant brunt manifesting into a visibly moderating growth for the country. Nonetheless, China is gradually rebalancing its economy and has taken steps towards greater policy accommodation.

The commodity prices remain muted dampening the outlook for commodity exporting EMDEs. According to World Bank's latest estimate (June 2016), the commodity exporting EMDEs are projected to grow at 0.4%, which is a downward revision by 1.2% from the January 2016 forecasts. Both Brazil and Russia remain in the recessionary mode.

The times have been difficult and India has not remained unscathed. However, even amid persisting uncertainty globally, India has emerged as the fastest growing economy in the world. The country has been able to hold on to a steady growth by constantly working to maintain a sound macro-economic policy framework and anchoring itself to a committed reforms path.

India's GDP growth picked up from 7.2% in 2014-15 to 7.6% in 2015-16 and the Economic Survey pegs an estimate of 7.0-7.75% growth for 2016-17. Though the latest available numbers for Q1 2016-17 reported a GDP growth of 7.1%, which was lower than 7.9% growth observed in Q4 2015-16; growth is expected to witness an uptick in the latter part of the current fiscal year.

An anticipated improvement in agriculture and industry sector performance is likely to aid the recovery process. Monsoons have been normal this year with good spatial distribution, which is a big positive. Kharif acreage has been reported to be much higher vis-à-vis the previous year according to the data available till date.

Also, some signs of stimulation in the domestic demand pulse have been evident. Domestic demand is likely to get an additional impetus as the benefits of a good monsoon and award of Seventh Pay Commission pan out going ahead.

In fact, this pickup in demand is also corroborated in the results of various FICCI Surveys conducted recently. The survey results indicate some improvement in the capacity utilization rates of reporting companies. The participants also expected greater buoyancy in demand going ahead.

However, what remains a matter of concern is the continuing apprehension amongst members of India Inc. to undertake fresh investments. The domestic capex cycle is yet to gather full momentum.

The trend in industrial activity is still underlined with volatility and firm signs of a turnaround are awaited. IIP growth numbers have been weak, reporting a growth of (-)0.3% over the first five months of the current fiscal year, vis-à-vis 4.5% growth reported during the same cumulative period (April-August) last year.

On the inflation front, while overall prices have remained range bound spikes were noted in the food price segment causing some uneasiness.

Prices of pulses have been a key pressure point treading in the double digit terrain for 21 consecutive months beginning January 2015. A surge was also noted in vegetable prices between May and July 2016 raising fresh concerns. However, latest numbers indicate food prices abating. The government has been keeping a close a vigil on price movements, following up with appropriate measures to improve supply side management.

As for other commodities (crude and metals), even though a marginal build up in prices came to fore off late, the situation is expected to remain benign given that countries continue to grapple with the issue of overcapacity.

The Reserve Bank of India in its latest Monetary Policy Report (October 2016) envisages a trajectory taking headline CPI inflation towards a central tendency of 5 per cent by March 2017.

At this juncture therefore it remains imperative that precedence is given to pushing growth. On the investment side, it is essential that the cost of capital is made more competitive. The Reserve Bank of India has cut the repo rate by 175 bps since January last year. The Government had also announced a cut in the small saving rates earlier this year. It remains critical that Banks take cognizance of the situation and transmit these cuts by lowering the lending rates.

Interest sensitive sectors such as consumer durables, automobiles and housing will notice an uptick in a moderate interest rate regime and it is important that all policy levers are put in place to propel growth.

On the external front, India's merchandise exports have been contracting since December 2014 with an exception of a mild recovery noticed in June 2016. India's non-petroleum non-gold and silver imports have also been in the negative terrain since August 2015, with the only exception of positive growth noted in February 2016. Even though, the government has taken steps to address the concerns of exporters, a recovery in exports is contingent on a consolidated recovery shaping up in the global economy which is still sometime away.

2.2. Government Continues to move along the Reforms Path

Government is almost half way through its tenure and the progressive approach it has adopted towards bringing a change is laudable. The reform agenda of the Government has been very comprehensive and what is even more praiseworthy is the commitment displayed to carry forward this agenda.

In 2016, the Government continued to move ahead in the direction of policy announcements made over the course of past two years, working in sync with the overarching objective of assuring a conducive environment for businesses.

The year started with the announcement of Start-up India campaign in January 2016. The initiative provides an excellent platform to a large number of young entrepreneurs in the country to come forward and concretize their ideas. The incentives offered as a part of this strategy are very encouraging.

Then, one of the biggest achievements this year has been the enactment of the Constitution (122nd Amendment) Bill to introduce the Goods and Services Tax (GST). The Constitution Amendment Bill for GST was cleared in both the houses of the Parliament, ratified by the requisite number of states and has also received the President's consent. The implementation of GST will be the single biggest reform in India's history and could add 2 percentage points to India's GDP growth in the medium term. GST is expected to become operational by April 2017.

The Government took a step further in 2016 to position India as one of the most liberalised countries in the world by further overhauling India's FDI regime. In June 2016, the Government further simplified the policy framework governing investments in a whole host of sectors including strategic sectors like defence and aviation. This is a huge positive for the economy. While a host of sectors have been opened up under the automatic route, FDI limits have been increased for those sectors that require approval.

The passage of the Insolvency & Bankruptcy Code Bill in the Parliament is another key reform that went underway this year. The passage of the Bill is a major step towards assuring ease of doing business and will help assure greater legal certainty and speed in closure of businesses that need winding up due to genuine reasons.

India's monetary policy framework finally went through the major overhaul with the Monetary Policy Committee coming into force at the fourth bi-monthly policy announcement on October 4, 2016. A six member committee has been put in place, with three members from the Reserve Bank of India and three external representatives to jointly decide on the policy course. This is expected to further reinforce the partnership between the Government and the Central Bank with the objective of managing inflation dynamics.

Other landmark reforms this year included passage of the Real Estate Bill and announcement of the much awaited Intellectual Property Rights Policy.

2.3. Union Budget 2017-18

Last year's Union Budget was a step forward towards achieving the development agenda set out by the Government and carried forward the reforms program. The Budget gave due cognizance to the need to address the issue of weak demand and aptly emphasized on pump priming demand in the economy by laying adequate focus on the agriculture, rural and infrastructure sector.

Between the last year's Budget and the forthcoming one, what remains unchanged is the fact that the impetus for generating growth will have to come from the domestic economy. The Government will have to continue playing the role of a catalyst to give a boost to the economy. Weak investments and subdued demand conditions remain major concern areas.

While detailed proposals for various sectors are given in the following pages, some of the broad suggestions which FICCI would like to make for government's consideration are as follows –

(a) **Continue the focus on ease of doing business:** Assuring ease of doing business has been a top priority for the Government and several initiatives have been taken to provide for a conducive environment for businesses. The Government should continue the work on this front and should consider –

- Setting up of a Regulatory Review Committee to review business regulations, laws and processes and do away / amend those regulations that are no longer relevant or create multiplicity or lead to over-reach. Introduction of a sunset clause for periodic review of any new legislation / rule is also desired.
- Government should create an inter-ministerial forum that meets on a quarterly basis, where industry, banks and other stakeholders can seek quick resolution on issues involving more than one ministry.
- Ease of doing business is extremely important for MSMEs, who face time and capability constraints in adhering to complex procedures and compliances. There is a need to have a single window mechanism for MSMEs that serves as one-stop shop service for all business related compliances, with in-built provisions for time bound and deemed clearances.

(b) **Continue with the thrust on infrastructure:** Infrastructure development is one of the most critical prerequisites for driving economic growth and accelerating infrastructure activities in the country has been a key focus for the Government.

- Given the huge fund requirements for infrastructure financing, the Government may consider launching funds similar to the National Investment and Infrastructure Fund, perhaps, with other countries as co-investors. Such funds can be managed by professional fund managers and leveraged multiple times by providing equity for large projects across sectors.

- The Government could look at encouraging States to sign 'State Support Agreements' for large projects as this will commit states to ensure timely implementation of projects.

(c) **Continue work on cleaning bank balance sheets:** Indian banking system is going through a challenging phase due to build-up of a large volume of stressed assets. Several steps have been undertaken by the Reserve Bank of India and the Government over the past two years to address the situation. While remedial actions are underway, the focus has to be on the preventive measures as well that can help us keep a check from falling back into a similar situation.

- For an effective resolution of stressed assets, there is a need to look beyond the existing system and address the specific nature of the problem through a specialized ARC framework. FICCI once again reiterates creation of a specialized entity called National Asset Management Company (NAMCO) to effectively tackle the issue of large NPAs.
- It is proposed that a National Asset Management Advisory be formed to facilitate effective execution and bring in the needed expertise to the Strategic Debt Restructuring process.

(d) **Continue on the path of widening the tax net:** The government needs to take steps to improve the tax to GDP ratio that continues to hover close to the 10% mark. Widening of the tax base and formalization of the informal economy should be given priority in the forthcoming Budget. There is a need to tax all sectors which are presently outside the scope of the tax net albeit at much higher levels of income/wealth. There is no economic justification to not tax persons who have income above the threshold of maximum marginal rates payable by other tax payers.

- Consider making filing of returns / declaration of all incomes mandatory over a particular threshold (say Rs. 10 lakh), irrespective of source of income.

(e) **Continue giving an impetus to domestic manufacturing:** India is well poised to take advantage of restructuring of the world manufacturing base. India has opened up its foreign direct investment regime. Also, the Government has undertaken significant reforms to provide a conducive environment for businesses. Further, India has already developed a very large engineering and manufacturing capability. It is time to leverage these strengths and reaffirm India's position in the global manufacturing landscape.

- Take adequate safeguard measures to ensure that Indian players in sectors such as steel, tyres, chemicals, paper etc. can have a level playing field vis-à-vis imports especially from countries with which we have a FTA.
- Review and take stock of existing FTAs. There must be a clear shift in balance towards providing greater market access to our companies abroad. Disseminate information amongst the domestic industry on the market access opportunities that follow any FTA India signs.

SECTORAL ISSUES

AGRICULTURE

3.1.1. Unified National Market for Agricultural Commodities (e- NAM)

Government of India boldly put forth the vision of creating a unified national market for agricultural commodities through the launch of the e-NAM initiative in April 2016. However, the progress so far has been slow. Farmers and corporates alike await the unleashing of e-NAM's full potential to provide greater selling choice to farmers and reduce transaction costs and improve quality for buyers. It is therefore suggested that the following steps may be taken in the forthcoming Budget to revitalize e-NAM to ensure the full delivery of its benefits:

i) Creation of a joint venture company with 50:50 public and private holding and allocation of the mandate to roll out e-NAM to this entity. Government of India should offer free equity from the public shareholding to all States.

ii) Free e-NAM from bondage of APMC market yards and allow trading hubs (with minimum prescribed criteria) to be created at Gram Panchayat/village haat level, linked to e-NAM portal. This will unleash a marketing revolution in the country and create huge employment potential in rural areas.

iii) Enactment of a special legislation under the "trade" entry of the Union List of the Constitution to enable smooth and seamless passage of agricultural goods traded on e-NAM across State borders. This will help to override the physical barriers erected by APMC legislation in various States.

iv) Cap the fee payable on inter-State transactions on e-NAM at 1% to incentivize large buyers to get onto the platform.

v) Provide a financial incentive to States for the number of e-NAM trading points they facilitate (say Rs. 10 lakhs per point, subject to a ceiling of 200-500 points in the State, depending on size).

3.1.2. Crop Insurance and Related Measures

With PMFBY (Pradhan Mantri Fasal Bima Yojana), Government of India has taken a big step towards insurance of crops. However, for the success of the scheme it is important that States as well as Central Governments should make provision for timely subsidy to insurance companies. This would be important to serve the additional features such as prevented sowing on account claims and localized claims.

There is a need for insurance in agriculture allied sectors also. Therefore under PMFBY, flagship program for livestock and fisheries should also be included. This will help in bringing investment in newer technologies supported with hedging of risks using insurance instruments.

Under PMFBY, the state governments should invest in a series of automatic weather stations (AWS) or rain gauges (ARG) to identify the weather conditions at local level. As per few studies, India needs to have one AWS at every 5 km and one ARG at every 2 km or one AWS in every village. This requires considerable investment at state and central level.

3.1.3. Separate Category for Organic Products under Central Excise Tariff with nil Rate of Duty

Since the introduction of Bio products from about last 10-15 years (such as organic fertilizers, antagonistic microbes , organic extract, which are the cultures of microorganisms other than yeast which aid plant growth or natural Organic extracts produced from plant, animal or vegetable origin) the tariff classification under Central Excise Tariff is same and no effort has been made to categorize them in distinct group based on their composition and mode of action especially from the synthetic / chemical products. These bio products have a completely different mode of action than the fertilizer; therefore they need to be separately classified as Organic Product with nil rate of duty.

3.1.4. Agri Warehousing

The post – harvest value chain of the Indian agriculture and food sector is a vital part of Indian economy .The country loses about 8-10% of food grains every year due to post harvest wastages. The losses/wastages in fruits and vegetables segment are even more alarming. This not only leads wastage of food grains but also depresses farmer incomes. Due to lack of storage facilities, Agricultural produce is often stored in the open leading to deterioration. Further, the inadequacy of storage facilities causes farmers to sell their produce immediately upon harvest when the Mandi prices tend to be the lowest. To alleviate these problems, it is important to provide appropriate incentives to set up good warehousing facilities and allied benefits to the post-harvest ecosystem. Suggested measures are as follows:-

1. To promote efficiency in procurement operations the Government of India (GOI) has recently announced a new policy of engaging private sector players for Eastern states. The same should be extended for pulses procurement where GOI has announced its policy for creation of a buffer stock for 2 million MT of pulses. Along with procurement under MSP, credible private sector entities should also be outsourced for stock management services to improve efficiencies and ensure improved quality of preservation of food grains.
2. Approximately 15 MMT of Agro warehousing has been built or contracted under FCI 7/10 year guaranteed scheme. However, still there is estimated gap of 15 MMT in agro warehousing in the country. In this context the policy recommendations are as follows:-
   a) The capital subsidy under the Grameen Bhandaran Yojana should be restored. In the interim the projects where the loans have been sanctioned should be restored.
   b) The tenure of Warehousing construction lending is low and Return of Income (ROI) is high. It is suggested that the terms from NABARD to fund agro warehouses should be revisited. It is suggested that repayment period should be increased to 10 years and the ROI should be in the range of 7.50 % to 8%.
   c) Multiple regulations/registration requirements make agro warehousing an unviable business. There should be single regulator in WDRA (Warehouse Development and Regulatory Authority) to bring much needed transparency and hence, better regulations and investments in the sector.
   d) Capital subsidy for cold stores should be enhanced and also extended to all capital investments in back end supply chain logistics to reduce the losses in fruits and vegetables.
   e) Investment in Solar Technology Applications for Cold Chain to Reduce Dependence on Electricity in Rural Areas should be increased.

3.1.5. Farm Machinery

A. Waiver of basic import duty, CVD and applicable cess for the following equipment not manufactured in India:
   1. Machines for Forage Harvesting, Maize Harvesting and Mechanized rice transplanting,
   2. Combine Harvesters (above 200 horse power & 15’ cutter bar),
   3. Tractors above 80 horse power to be used in specific heavy duty applications like operation of bigger balers etc.

B. Government support for promotion of Custom Hiring Centers

   To increase productivity, farmers need to use modern farm machinery. However, it is unviable for small and marginal farmers to buy the necessary machinery. To facilitate usage of such equipment, Custom Hiring Centers (CHCs) are now gaining acceptance where farmers can hire equipment on pay-for-use model without incurring the capital cost and maintenance expenses associated with such equipment. To promote setting up of Custom Hiring Centers by private entrepreneurs, the Government should provide support in form of Project Subsidy.

Equipment subsidy may be provided in a phased manner as follows:

1st year: 75% subsidy on 50 Lacs investment

2nd year: 50% subsidy on 50 Lacs investment

3rd year: 25% subsidy on 50 Lacs investment

To ensure viability of the investors, they must be provided autonomy on the operations and setting of hiring rates.

CEMENT

3.2.1. Excise Duty Rationalization and Simplification

Duty rates on cement are one of the highest and next only to luxury goods such as cars. Other core industries such as coal, steel attract duty at around 6% Cement is one of the core infrastructure industries and it requires large-scale investments and capacity additions in view of the expected GDP growth and projected demand for cement over the medium to long term. The excise duty structure for both cement as well as cement clinker has become quite complicated in the last few years. Earlier it was at a specific rate per MT. Now, it has attracted ad-valorem cum specific duty and is further also related to the declared MRP of the product. There is surplus capacity of cement in the country and cement market is on bearish trend.

To encourage Cement Industry and bring it at par with other core and infrastructure industries, the Excise Duty rate on Cement should be rationalized and reduced from the current 12.5% plus specific duty to 6-8% without addition of specific duty. Also, the duty structure be simplified to be either on specific rate per MT or on advalorem basis and without relating to MRP etc.

3.2.2. Increase of Abatement Percentage

As per Section 4 of Central Excise Act, Excise duty on Cement is levied on transaction value. In case of bags on which Maximum Retail Price (MRP) is printed, MRP is considered as transaction value. Since MRP consists of excise duty, VAT, freight component, post sales expenses and discount etc. MRP works out very high as compared to transaction value. Moreover in cement industry, billing is done at a higher price and subsequently credit note is issued for all types of discounts/incentives viz. Rate difference, Cash discounts, annual incentives etc. which ultimately result in reduction of net realization of the company whereas excise duty is paid at a higher value which is 70% of MRP.

In view of the above facts, it is suggested that existing abatement of 30% may be increased to 55% as the expense to the cement industry is more than the benefits availed of due to abatement. Abatement of 55% was also recommended by NCAER. Even for other sectors, like Readymade garments and made up articles which are covered in Chapter 61, 62 and some specified under 63, abatement is applicable at 70%.

3.2.3. Levy of Customs Duty on Cement Imports

Since 2007-08 import of cement into India is freely allowed without having to pay basic customs duty whereas all the major inputs for manufacturing cement such as Limestone, Gypsum, Coal, Pet coke, Packing Bags etc. attract customs duty. Presently due to low demand of cement in the country more than 116 million tons of domestic cement capacity is lying idle and duty free import of cement causes further undue hardship to the Indian cement industry already reeling under low capacity utilization apart from the security concerns inherent in the import of cement from Pakistan.

Therefore, it is requested that to provide a level-playing field, basic customs duty be levied on cement imports into India.

3.2.4. CENVAT Credit of Clean Energy Cess on Coal

Clean Energy Cess has been levied on coal peat and lignite w.e.f. 1.7.2010. Energy Cess is one of the major cost drivers

for production of cement. Though levied as a duty of excise, no CENVAT credit is being allowed against this cess. Further, now even Excise Duty has been levied on coal. This cess, along with state VAT etc. is putting further pressure on an industry faced with surplus capacity, falling realizations and increasing costs.

It is requested that CENVAT credit be allowed on Clean Energy Cess so as to mitigate the impact on costs.

3.2.5. Withdrawal of Excise Duty on Fly Ash

Excise duty has been levied on fly ash, which is a waste product generated on burning of coal in the boiler of power plant.

In this regard the decision of the Hon'ble Supreme Court in case of Union of India vs. Ahmadabad Electricity Co. Ltd., in 2003 (158) ELT 3 (SC) has settled the issue that use of coal as fuel to produce steam resulting in fly ash as a byproduct cannot amount to manufacture. There is no change in the process of generation of fly ash viz. a waste generated on burning coal in the boiler. Therefore, the above judgment still holds good and hence fly ash generation is not to be treated as manufacture and no Excise Duty on fly ash be levied.

CHEMICALS AND PETROCHEMICALS

3.3.1. Background

Chemicals industry is a diversified industry and covers more than 80,000 commercial products. It provides key building blocks to a host of downstream industries as a result it plays a key role in the economic and social development of the country. It is a critical element of the manufacturing industry. Indian chemical industry is estimated to be valued at $147 bn in 2015 and contributes to 3% of the global chemical industry. India's chemical's trade balance is negative with imports being significantly higher than the exports. Net imports have grown at 17% p.a. during the 2011-15 period.

The chemical industry continues to face several challenges. Availability of feedstock at competitive cost remains a key concern. Lack of domestic manufacturing of several intermediates increases lead times and lowers competitiveness of downstream producers. Lack of adequate physical infrastructure and sub-par chemical logistics infrastructure makes material production and movement cost intensive. Uninterrupted power supply remains a challenge for the energy intensive chemical industry. To add to above, significant glut in global chemical capacities has led to growth of imports in India. Large capacity additions in Middle East and USA are another cause of concern for the domestic players. The duty structure needs rationalization for several products value chains in order to boost domestic value addition. PCPIRs implementation is yet to take off as expected. Only four states, Gujarat, Andhra Pradesh, Orissa and Tamil Nadu have so far shown interest in developing PCPIR regions, but implementation in spirit is lacking.

3.3.2. Feedstock for Chemical Industry

(a) Reduction in Customs Duty on Feedstock Ethyl Alcohol

Ethyl Alcohol or Ethanol (HS code: 22072000) is a versatile feed stock for the chemical industry. It has applications in fuel blending, potable liquor, Pyridine, Mono Ethyl Glycol (MEG- further used for Polyester Fibre and Films, Packaging Films and Pet bottles etc.). Ethyl Alcohol is also used for making Acetic Acid, Ethyl Acetate and Acetic Anhydride. Most of these products (Pyridine, Ethyl Acetate etc.) are exported out of country and are major building block for various agro chemicals and pharmaceuticals products.

India faces shortage of Ethyl Alcohol, for reasons of lower production compared to the demand, which is further increasing, in view of the policy of the Government to encourage Ethanol blending with petrol. In 2015-16, molasses based ethanol production is estimated to be lower compared to previous year because of the lower sugar production in the country which will further widen the deficit. Launch of 5% Ethanol Blending Programme with the requirement of 105 crore litres of ethanol has raised the demand. This has further increased price of ethanol available to chemical

industries. Due to the inadequate supplies of ethanol in the domestic market, Indian Chemical industry is forced to import ethanol. In the past five year, ethanol has been continuously imported and with the existing scenario, the chemical industry would be dependent on ethanol imports for its major requirement. Removal of Duty will further boost the export of such products and will increase the forex revenue for the country.

It is recommended that Import duty for Industrial Ethanol be fully exempted in line with duty on other competing feed stock to make ethanol based chemical industry compete with alternate petro route and in global markets for its finished products.

(b) Reduction in Customs Duty on Feedstock Methyl Alcohol

Methanol (HS code : 29051100) is an important feed stock for manufacture of Acetic Acid, Formaldehyde, Di Methyl Ether, Methyl Tertiary Butyl Ether, Gasoline etc. which are major basic building blocks for majority of chemicals in India. Methanol consumption in country is estimated at 1.8 - 2.0 million tonnes and is expected to reach 2.5 million tons by the end of the 12th five-year plan. The current production capacity in the country is 0.385 million tonnes/annum thereby creating a significant gap which would primarily be met through imports from Middle East and China. The removal in duty on methanol will surely boost the downstream industry and will reduce outgo of foreign exchange from country also the resultant lower cost of production will increase the profitability of end products exported out of country.

There exists strong opportunity in investment in methanol capacity in the country, but these are limited by feedstock (naphtha and natural gas) availability. In such a scenario, the government can incentivize the development of downstream industry by removing customs duty on methanol and thus facilitating availability. It is accordingly recommended that Basic customs duty on Feedstock Methyl alcohol should be fully exempted as this will promote growth of downstream chemical industry products.

(c) Reduction in Customs Duty on Feedstock Acetic Acid

Acetic acid (HS code: 29152100) is an important organic chemical and critical building block/raw material for various downstream industrial chemicals like ethyl acetate, acetic anhydride, poly vinyl acetate etc. India is net exporter of these downstream products. India's total Demand of acetic acid is ~1 Million MTPA growing at 7.5% of which domestic production is ~15%, rest ~85% is import dependent. India is net exporter of acetic acid derivatives like Ethyl Acetate, acetic anhydride, PTA and other acetic acid derivatives. Acetic Acid is important feedstock for these products and to remain competitive in exports, a zero duty acetic acid imports are highly required. Basic import duty on Acetic Acid should be reduced to Nil (from current level of 7.5%).

(d) Inverted Duty issue - Ethyl Acetate

India is among the top 5 global producers and is a net exporter of ethyl acetate (HS code: 29153100). India is dependent on Singapore for acetic acid imports. In view of the lopsided FTA, the company which supplies the acetic acid as well ethyl acetate has a cost and logistic advantage. India is not able to compete with them.

Under the Singapore FTA, import of Ethyl acetate suffers 0% duty whereas Acetic acid which is used as input in manufacture of Ethyl Acetate is subject to 5% duty. Hence, there is an inverted duty structure which needs rectification. Hence, customs duty on Ethyl acetate needs to be introduced on par with acetic acid.

(e) Inverted Duty on Acetic Anhydride

India is net exporter of Acetic anhydride (HS code: 29152400) but net importer of the raw material Acetic acid. Our current capacity of this chemical is sufficient to meet domestic demand. Under Singapore FTA Acetic Anhydride is zero duty while its key feedstock is imported at duty of 5 to7.5%. Though current imports are low but such duty structure is

a probable threat for domestic industry.

It is suggested to keep Acetic Anhydride duty rebate to be revoked and exclude it from any ongoing/under-negotiation FTAs providing duty free imports of the feedstock Acetic Acid (HS code: 29152100). It is further requested that MEIS benefits should be given at 5% to make Acetic Anhydride manufacture competitive

3.3.3. Chlor Alkali Industry

Caustic soda, soda ash and chlorine are basic building blocks that find applications in products of everyday use. Though India's share of global manufacturing capacity is very small, these are important segments that will grow, driven by mass consumption and growing aspirations of our people.

The present global capacity of Caustic Soda is estimated at 102 million MTPA while India's capacity is only 3.4 million tonnes i.e. a mere 3.3% of the world capacity, while China has a capacity of 40 million tonnes i.e. almost 40% of the world capacity. Similarly the global Soda Ash capacity is 60 million MTPA. China has the largest capacity at 25 million MTPA or 41.5% of total global capacity, while India's capacity is only 3.1 million tonnes i.e. 5.2%. Global PVC Capacity is estimated at 55 Mn MTPA and India's capacity is stagnant at 1.4 Mn MTPA (2.5%). In comparison, China's capacity is 23.89 Mn MTPA (42% of global capacity).

(a) Caustic Soda and Soda Ash

Caustic soda and soda ash are basic building blocks in which the domestic industry has adequate capacities to meet domestic demand in full. The Indian industry has invested substantially in upgrading to the latest and most energy efficient membrane cell technology for producing caustic soda. The industry continues to be at a disadvantage as high cost of power adds to overall manufacturing costs.

India offers a huge market which will continue to grow with expectations of a healthy GDP growth in the coming years. This market potential coupled with the high domestic manufacturing costs gives an unfair advantage to countries with low power costs and having surplus unutilised capacities. The absence of a level playing field to the domestic industry provides ready access to countries like China, Korea, Taiwan, Middle East, etc. who are able to easily service the Indian market.

An increase in customs duty from 7.5% to 10% will partially offset the disabilities the Indian industry suffers.

(b) Clean Environment Cess on coal

The Clean Environment Cess on coal was increased to Rs.400 per MT in the last Union Budget. The alkali industry is energy-intensive and most manufacturers have set up coal-based power plants at considerable investments as supply from the grid is erratic and not of consistent quality. The increase of Clean Energy Cess to Rs.400 per MT is a major burden which will further weaken the competitiveness of the Indian industry. The industry requests that this cess should be removed totally or be made cenvatable.

(c) Customs Duty on Import of Power Equipment for Captive Power Plants

Caustic soda manufacturing is power intensive with power constituting nearly 60% of total production cost. Erratic supply and non-availability of quality power has resulted in manufacturers setting up captive power plants at huge investment costs (per MW cost being about Rs.6 crores for coal-based power plants). Additionally state governments have imposed cess, electricity duty and various other taxes which add to the cost of power.

The industry requests that power equipment imports for setting up captive power generation be fully exempted from customs duties.

3.3.4. Agrochemicals /Crop Protection Chemicals Industry - Pesticides

India has a very vibrant Pesticides industry, which not only caters to the domestic demand, but also undertakes substantial exports. Pesticides are one of the important agricultural inputs used by farmers to protect crops from the ravages of

pests and diseases as also for public health. According to the Standing Committee Report of Ministry of Chemicals & Fertilizers, annual crop losses in India due to pests and diseases is worth Rs. 90,000 crores, a major part of which can be saved by judicious use of pesticides. Due to increased rate of various duties and taxes, pesticides are becoming expensive to farmers particularly to small land holders. Usage of pesticides in the country is very low. Judicious usage can result in enhanced production. It is important to support agriculture production in the country as about 60% of its population still depends on Agriculture directly or indirectly. It is requested that Excise Duty on Pesticides (including Bio Pesticides) be reduced from the present level of 12% to 4 %. It is pertinent to note that agricultural inputs other than pesticides, such as Fertilizers, farm implements, Seeds etc. enjoys various concessions including exemption from levy of excise duty. Pesticides are also one of the key inputs to protect the crops from pests and diseases, but similar concessions are not given to pesticides.

3.3.5. Oleo Chemicals and Toilet Soap Industry

(a) Review ASEAN Free Trade Agreement

Oleochemicals and Toilet Soaps are manufactured from vegetable oils such as Palm Kernel / Palm oils and its fractions. India is a net importer of vegetable oils, both for edible consumption and industrial uses. Main oleochemicals are Fatty Acids, Fatty Alcohols which are environmentally friendly chemicals derived from vegetable oils. Its main uses are in Toilet Soaps, Personal and Home care industry and hence its domestic production compliments growth of Personal and Home Care products manufacturing in India. However, ASEAN FTA has adversely affected domestic competitiveness of Oleochemical and Toilet Soap Industry sector as FTA import duties on these products have become zero but import duties on its raw materials, viz. Palm Kernel/Palm Oil and its fractions for industrial consumption continue to be as high 100%. This has not only resulted in an inverted duty structure but has threatened the existence of this industry sector in coming years, unless corrective action is taken to remove this anomaly.

South East ASEAN (SEA) countries like Malaysia, Indonesia and others are world’s largest producers of Palm Oil, Palm Kernel oil and its fractions. These countries have imposed export duty as high as 25% (linked to the price of Crude Palm Oil) and Biofuel Levy of USD 50 per MT on export of such raw materials and hence given indirect economic incentives to their domestic manufacturers of downstream products like fatty acids, fatty alcohols, soap noodles, toilet soaps, surfactants and other value added derivatives. These measures have resulted in building up of huge manufacturing capacities in these countries and have disturbed the demand supply balance resulting in oversupply of the above mentioned finished products. Domestic manufacturing is adversely affected because of non-competitiveness against the aggressive imports from ASEAN countries and particularly from Indonesia, Malaysia and Thailand. There are several hundred small and medium scale manufacturers of soaps, surfactants and Oleochemicals, who have employed several thousand people and have no capability to shift their base to South East Asia. They would continue to suffer if no corrective measures to provide them level playing field are taken by the government.

The suggestions to revive the industry are as follows:

- ASEAN FTA needs to be urgently reviewed and duty structure hurting Oleochemicals, Surfactants, Home and Personal Care Products needs to be corrected by imposing reasonable import duties to protect domestic manufacturing industry.
- Chapter 3401 and 3402 which cover all the surfactants, Soap Noodle, Personal and Home Care Products that use raw materials imported from Indonesia / Malaysia should be removed from ASEAN FTA and should be listed under normal track and an import duty of 15-20 % (as it was applicable prior to its inclusion in ASEAN FTA) should be imposed immediately to save extinction of this industry segment.
- Chapter headings 382370 and 290517 which cover Fatty Alcohols, which also depend on the raw materials imported from Malaysia / Indonesia should also be removed from the ASEAN FTA and be listed under normal track and an import duty of 15-20% be imposed on its import to India.

(b) Customs Duty on Vegetable Oils used for Oleochemical and Toilet Soap Manufacturing

South East Asian manufacturers use natural quality raw materials like Crude Palm Oil (HS Code 1511), Palm Kernel Oil (HS code 1513) for manufacturing high quality finished products. Considering the sensitivity of the imported oils,

especially Crude Palm Oil for edible application, Government by Notification No. 12/2014-Cus dated 11-07-2014 has allowed Indian manufacturers of Soaps and Oleochemicals to import of Crude Palm and Palm Kernel Oil with minimum 20% FFA content at NIL rate of duty on actual user conditions. However, there are several difficulties in getting such blended oil from these countries and have following issues for the same.

1. Indonesia is currently the largest exporter of Crude Palm oil/Crude Palm Kernel Oil and its fractions viz. Naturally produced Palm Oil has FFA of less than 5% and hence to make 20% FFA containing Palm/Palm Kernel oil, Fatty Acid Distillates/Crude Fatty Acids are blended in natural Crude Palm/Palm Kernel oil. Therefore, it attracts additional cost of making such blended oil and also Export Duty and Biofuel Levy making it costly for Indian importers.

2. Indian manufacturers incur substantial cost to process such 20% FFA oils that are not natural but are blended/ mixed oils containing Fatty Acid Distillates (Palm Fatty Acid Distillate (PFAD) or Palm Kernel Fatty Acid Distillate (PKFAD)]/ Fatty Acid Residues/ Crude/ Split Fatty acids. This not only makes them non-competitive in the market but they also face quality issues in meeting global standards and finding it difficult to meet the competition from Malaysia/Indonesia.

3. Therefore, the customs duty exemption granted for vegetable oil having 20% or more FFA is not at all beneficial to the Indian Importers due to the increased processing cost, higher incremental export duty (in Indonesia) on the blended product as per the revised rules and limited availability of such oils. Ultimately, these imports will only benefit the tax kitty of Indonesian Government that is collecting additional export duty on the 25% of quantity of Fatty Acid Distillates/split fatty acids of the said blend.

4. Considering the sensitivity and (unfounded) fear of diversion of Crude Palm Oil for edible purpose, Government can consider selectively exempting Crude Palm Kernel Oil, which a unique oil used by this industry, from the requirement of minimum 20% FFA condition as this oil imports are less than 1% of the total import. This oil is a critical raw material for soap and oleochemical industry without any alternative available in the domestic market.

5. Since Sl.No.51 of Notification No.12/2012-Cus dated 17.03.2012 as amended by Notification No.12/2014-Cus dated 11.07.2014 already permits imports of these Oils with Free Fatty Acid (FFA) 20 per cent or more at NIL rate of duty to the manufacturer importers on the basis of requisite certificates issued by excise authorities that the imported goods are for use in the manufacture of Soaps and Oleo chemicals, by removing this condition of minimum 20 % FFA would not have any negative impact on the revenue. On the contrary it will reduce incremental FOREX outflow and will also give level playing field to domestic manufacturers with those from Malaysia/ Indonesia and would also support to Government's Make in India imitative.

Therefore, to overcome this issue and as the duty exemption Notification No.12/2014-Cus dated 11.07.2014 is given on actual user condition (no 5), we request the Government to remove this additional condition of "Free Fatty Acid (FFA) 20 per cent or more" and allow Toilet Soap and Oleochemicals manufacturers to import at least only crude palm kernel oil (HS Code 1513) as their raw materials in its natural form without the condition of FFA at NIL rate of duty. This change would help our industry to become more competitive against the imports of Toilet soaps and Oleochemicals, boosting domestic manufacturing without any additional burden on the Governments revenue and would support Government's initiative of "Make in India".

(c) Review of Customs Duty differential of Crude Oils and Refined Oils

India is importing over 15 MMT of vegetable oils which are mainly for edible consumptions. Amongst these imports, large part constitutes import of Refined Oils due to economic advantage and lower export duties in Indonesia/Malaysia on export of refined oils. Currently customs duty differential between Crude Oils and Refined Oils imported for edible consumption is only 7.5%. This duty differential is not sufficient to convert imported Crude Oils in to Refined Oils in India as its refining cost is more than the duty saved on its imports. India has a very large installed capacity of vegetable oil refining. This low duty differential has resulted in to very low capacity utilization of the Indian Vegetable Oil Refining Plants and which are totally idling.

The Customs Duty Differential between Crude Oils and Refined Oils should be minimum 15% which will immediately help in increased refining of vegetable oils in domestic market and reduce imports of Refined Oils, thereby reducing outflow of the incremental FOREX. Increased Vegetable oil refining in domestic market will also result in to increased production of refining by-products like Fatty Acids Distillate (viz. PFDAD from Palm Oil) which are used for the production of Oleochemicals and Toilet Soaps. This will also help the local industry to source these raw materials at competitive prices.

3.3.6. Paint Industry - Reduction in Customs Duty on Titanium Dioxide

This is an important input for the Paint industry. Customs duty on majority of the chemicals is 7.5% except Titanium Dioxide (Tio2) which is charged @ 10%. Customs duty on Titanium Dioxide needs to be brought down in line with the other chemicals. Ti02 constitutes more than 80% of the imported chemicals used for paint manufacturing.

3.3.7. Chemical Clusters

The Chemical Industry has special requirements of dealing with toxic effluent discharge. This sector is important being facilitator of national economic development. Big part of Indian Chemical industry is in small and medium sector and same restricts the capability of investment of entrepreneurs for adoption of newer technologies. Same is essential to be globally competitive, both on cost and quality aspects. The provision of common facilities in the form of good quality power/water supply, effluent treatment/incineration, testing and other logistic facilities such as chemical storage tanks, telecom/firefighting and rail/road connectivity/boilers etc. can facilitate the sector. Further if related industries are set up in close proximity in an industrial estate, they could be vertically integrated resulting in a saving on the transfer cost of feedstock and finished goods. This, coupled with lower investment on infrastructure as a result of sharing, would tremendously improve their cost competitiveness. This will also help in containing the environmental load linked to the chemical industry. Such clusters could also be the points where migrating industry from west lands. Existing hubs (brown field) will need slightly different approach. About 3-4 such chemical clusters based on the best models, could be set up in different regions of the country and these could become the role model for replication. Department of Chemicals and Petrochemicals is already facilitating cluster approach in plastics sector. A similar approach is required for the chemical sector.

3.3.8. Technology Up-gradation Fund for Chemicals Industry

To remain globally competitive and comply with requirements of international conventions, Indian chemical industry needs to upgrade its technology to meet world standards and show improved performance in global trade. The industry, especially the micro, small and medium enterprise sector, does not have access to capital to upgrade technology on its own. Also, non-availability of technology leads to imports in some technology-intensive sub-segments. To address these issues, the government may establish a "Technology Up-gradation & Innovation Fund" (TUIF) that can address specific technology issues, faced by the industry. The fund should also support setting up of common chemicals infrastructure (e.g. effluent treatment plants, chemical waste disposal plants, etc.), which would benefit industries and the environment. From this fund support may be extended to the chemical industry for technology up-gradation at

lower rate of interest. This will help industry in improving quality of output and become more competitive. The same can be similar to Technology Upgradation Funding scheme in the Textile sector.

3.3.9. Petrochemicals

Petrochemicals are chemicals made from petroleum and natural gas and play a vital role in economic development & growth of the country as it enables the growth of other sectors in economy which includes agriculture, infrastructure, healthcare, textiles and consumer durables. The petrochemical industry is currently facing difficulty with pressure on prices and margins. However, despite the difficult business environment the domestic industry has made huge investments in creating new capacities for products like Polyethylene and Polypropylene. In order to maintain the financial viability of these new investments, appropriate fiscal support is critical. In certain key products like Poly Vinyl Chloride, investment has been severely lagging demand growth due to a lack of a facilitative fiscal structure. This is undermining the "Make in India" campaign and the vision for India's leadership in manufacturing. There are already large imports and huge outflow of foreign exchange. The situation would get aggravated as the trade gap continues to widen.

In the above back-drop, FICCI would like to make the following submissions for the Government's consideration for Budget 2017-18. The net impact of our proposals is revenue positive.

i. Import duty on polymers like Polyethylene, Polypropylene, and Polystyrene in India are way below the same in peer countries as is the duty differential between polymers and feedstock naphtha. Moreover, India already has substantial surplus of Polypropylene and is in the process of adding massive new Polyethylene capacities this year which will create huge surplus for Polyethylene as well. In view of the surplus in Polyethylene and Polypropylene import duty on polymers like Polyethylene, Polypropylene, and Polystyrene, be increased from the existing level of 7.5% to 10%.

ii. Polyethylene Terephthalate (PET) is derived through polymerization like other plastic raw-materials in chapter 39. However, while most of the major plastic raw-materials attract 7.5% duty, the same on PET continues to be 5%. PET is a vital raw material used both by textile and the packaging industry. Import duty on PET (HS code: 39076010, 39076020 and 39076090) may be raised from the existing level of 5% to 7.5% (10%, if duty on other polymers are raised to 10% as proposed) to bring this at par with other major commodity plastics.

iii. ABS and SAN are engineering plastics - advanced materials with superior properties mainly used in critical applications in automotive, appliances, electrical, lighting and electronic sectors. Domestic manufacturers have made significant investments over the years in creating ABS and SAN capacity in the country for meeting the requirement in these critical applications. It is proposed that import duty on ABS (HS code: 39033000) and SAN (HS code: 39032000) be increased from 7.5% to 10% aligning this with other major plastic raw-materials.

iv. Polyester is the key pillar of India's robust synthetic fibre industry. Indian manufacturers have made substantial investments in creating domestic capacities of fibre intermediates like PTA and MEG. However massive Chinese surplus capacity of PTA and MEG pose a serious threat to these investments today. To support the investments, it is proposed that duty on PTA (HS code: 29173600) and MEG (HS code: 29053100) may be raised from existing level of 5% to 7.5%.

v. Consequently, to rationalize the tariff structure for the entire value chain and avoid instances of duty inversion, import duty on POY (HS code: 54024600), FDY (HS Code: 54024700), PTY (HS code: 54023300), IDY (HS code: 54022090), TOW (HS code: 55012000) and PSF/FF (HS code: 55032000) be raised from the existing 5% to 7.5%.

vi. As consumption levels in India continue to grow, sectors like automotive have witnessed an upsurge in demand which is projected to continue. The growth in automotive has been supported by growth in the tyre and rubber goods sectors. The industry uses both synthetic and natural rubbers. While import duty on the major synthetic rubbers like SBR and PBR are at 10%, Butyl rubber or IIR has an import duty of 5%. The low duty on Butyl rubber

is resulting in large scale imports of the same thereby posing a threat to natural rubber producers in the country as well. In view of this import duty on Isobutylene Isoprene Rubber (IIR) (HS code: 40023100) and Halo Butyl Rubber (Halo Isobutene Isoprene Rubber-HIIR; H S code: 40023900) be raised from the existing 5% to 10% to rationalize the duty structure in the synthetic elastomers sector.

vii. Feedstock cost accounts for a major part of cost of production in petrochemicals. In Budget 2014-15, duty on most key petrochemical feed-stocks was reduced to 2.5% with the exception of Naphtha. Naphtha is one of the most widely used feed-stocks in India with over 55% of India's cracking capacity being Naphtha-based. Naphtha is also used for power and fertilizer production, wherein for fertilizer production it is exempt from import duty. Import duty on Naphtha in India at 5% is one of the highest, and consequently, the duty spread between the feedstock and end-product polymers in India is one of the lowest globally. In most countries, import duty on Naphtha is nil as it is the basic input for the industry. Import duty on key petrochemical feedstock Naphtha (HS code: 27101290) may therefore be reduced to 2.5% to bring it at par with other petrochemical feedstock.

viii. Mixed Petroleum Gas is a basic input to the chemical and petrochemical industry. In order to enhance the cost competitiveness of the industry, import duty on Mixed Petroleum Gases (HS code: 27112900) also be brought down from 5% to 2.5%. Similarly, duty on Kerosene (HS code: 27101910), another key input to the industry, may also be reduced from the existing 5% to 2.5%.

ix. LNG is the cleanest fossil fuel and a key input to the petrochemical industry. In the recent past, Government of India has reduced the customs duty of some of the alternative fuels to 2.5%. Coal also attracts 2.5% duty. LNG deserves a similar concessional duty. While power generating companies (other than captive generating plants) are entitled to import LNG at nil rate of duty, the captive power plants are deprived of such benefit. Ideally this disparity should be removed and captive power plants be made at par with other power generating companies. However, if reducing the duty to 0% is not acceptable, the duty on LNG (HS code: 27111100) should be at least be lowered to 2.5%.

x. Styrene is the principal raw material for Polystyrene. There is no domestic production of Styrene and the entire Styrene requirement of the country is imported. Polystyrene margins are under severe pressure and manufacturers are facing significant hardship. To provide relief to the product through reduction in input cost, import tariff on key petrochemical inputs Styrene (HS code: 29025000) may be brought down from the existing 2% to zero.

3.3.10. Poly Vinyl Chloride (PVC)

Poly Vinyl Chloride (PVC) is probably the most important plastic, a segment facing huge challenge in the country. Today unfortunately more than 1.7 million tons of PVC, representing almost 60% of the local demand, is imported into the country due to lack of local investment. The lack of incentive for creating local capacity in India has meant that, while PVC demand in India is growing at a rapid rate, same is being serviced by imports – by companies who are serving the Indian market from their overseas locations, rather than by setting up capacities in India.

This is also starkly brought out by the alarming increase in imports on a YoY basis – while imports in Q1 of FY 2014-15 was at 290 kt, it rocketed up to 408 kt in Q1 of FY 2015-16, a whopping increase of 41%., and further to 526kt in Q1 of FY 2016-17, an increase of a further 29%. Following proposals may be considered in this behalf:-

(a) Duty on Poly Vinyl Chloride

Indian import duty on PVC, at 7.5%, is still far lower than that prevailing in comparable economies. This is resulting in very poor margins for domestic manufacturers, leading to a complete disinterest in capacity additions.

Thus, India is even today excessively reliant on imports to meet its PVC demand, with demand expected to exceed 3 mn mt in the current financial year, while capacity is virtually stagnant at 1.4 mn mt. The gap is likely to widen more and more in future years as demand is growing at a CAGR of almost 12% while no capacity additions are on the anvil.

To redress this situation, it is requested that duty on PVC be raised to 10% from the present level of 7.5%.

(b) Duty on Key Intermediates EDC & VCM

We request that import duty on these items which is currently at 2%, be brought down to 0%. There is no local manufacture of these products for merchant sale in the Indian market; hence no Indian manufacturer will be affected by bringing down customs duty to nil. Facilities to manufacture these intermediates are usually set up only for captive use. This proposal will therefore not impact setting up of such facilities. In countries with developed petrochemical infrastructure, these are sourced off pipeline; in India, VCM is shipped under highly specialized conditions involving huge logistics cost, making domestic manufacturers uncompetitive compared to their international counterparts. The revenue impact is reasonably small at around Rs. 90 crores, which is more than made up by the increased revenue that can accrue from an increase in Basic Customs Duty (BCD) on PVC resin.

3.3.11. Synthetic Fibre Industry (MMF)

Indian Textile Industry is one of the leading industries. It contributes about 14% to industrial production, 4% to the GDP, and employs 45 million strong work force. Synthetic fibre (man-made fibre) is about 30% of same. Textiles bear differential duty treatment: manmade fibre, filament and yarn attract Central Excise @ 12.5% while natural fibres like cotton attract nil duty. The differential duty structure was primarily built with the perception that cotton was a fabric of the poor whereas man-made was otherwise. However, over the years, due to various technical development and low crude price, manufacturing cost of man-made fibre / yarns have drastically gone down. Globally the output ratio between man-made fibre and cotton is 70:30, whereas in India this ratio is reverse (30:70). This has been achieved globally on the back of fibre-neutrality. The industry has the potential to grow. To achieve this, India needs to have fibre availability of 22 – 25 Million Tons, from the present level of only around 10 Million MT.

It is suggested that an Intermediate Excise Duty regime i.e. Excise Duty rate of 2-6% with entire textiles chain in CENVAT be introduced. The present duty of 12.5% be reduced to 6% on MMF and its raw materials. The fibre forward chain which is currently Zero duty be brought under 2% excise across the Textiles Value Chain.

Further Customs duty structure should be a cascading structure i.e. the duty differential should be progressive at each stage of value chain. To save highly unorganized weaving industry from cheap Chinese imports, increase Customs duty on fabric falling under Chapters 54, 55 and 60 (made of manmade fibres) to 20% from the present 10%. Also the specific duty which is missing under the relevant HS codes be introduced at Rs.50/- per meter or Rs. 600/- per kg in line with other fabrics.

3.3.12. Plastics Processing Industry

This is an important segment of Indian industry with huge unrealized potential, going by the present very low levels of consumption in the country. Per capita usage is only about 11 kg in India as compared to about 105 kg in USA and 40 kg in China. The sector is also highly employment intensive, with above 3.6 million employment and is a big contribution of the sector to sustainable environment.

- 6000 MT of plastic furniture saves 140,000 cubic meter of wood or 32000 hectares of forest.
- Plastic crates have substituted almost 95% of wooden crates used in the soft drink industry.
- The only viable alternative to the wooden furniture is plastic moulded furniture.
- PVC doors and windows, plastics crates, plastics furniture can save at least 17.5 million trees from cutting. Plastic based wood substitutes are amenable to recycling.

The organized Plastic Industry is today hamstrung by the grey market – estimated to be as high as 40% -- on the one hand and under-invoiced, smuggled imports from China on the other.

It is requested that -

(i) Plastic Polymers and Articles of Plastics be placed in the lowest bracket of Excise

(ii) Import duties on plastic processing machineries (Extrusion, Injection moulding and blow Moulding) should be reduced to 5%. This will help in up-gradation of production facilities of our industry.

(iii) Import Duties to be raised to 15% minimum on finished Plastic products, in view of cheap imports eroding economic viability of SME units.

3.3.13. Setting up of Centres of Excellence

(a) Plasticulture

India currently supports nearly 17.84% of the world population, with 2.4% land and 4 % of water resources. As per International Water Management Institute, during the past decade, groundwater in various parts of the country, especially beneath the northern Indian states of Punjab, Haryana & western UP has fallen at an alarming level. This will impact the food security of the nation as the region also happens to be its food bowl. Hence, it is imperative that the country focus on improving the efficiency of water use in agriculture. Plasticulture (viz: the use of plastics in agriculture, horticulture, water-management, food grains storage and related areas) can play an important role in facilitating judicious usage of water. It is estimated that appropriate applications of micro-irrigation technologies can result in water saving up to 50-70-%. Consumption of fertilizer is also reduced through fertigation. There is need to encourage the Plasticulture sector to enable it to realize its potential and contribute to the national economy. There is a need to set up a Centre of Excellence which will work on aligning dynamic global developments with Indian conditions as also develop best technologies, take action on creating awareness on the important role of the sector. It will also facilitate skilling in the sector, thus generating employment.

(b) Indian Bureau of Corrosion Control

India loses a colossal figure of over Rs 2 lakh crores every year due to the menace of corrosion. The annual cost of corrosion worldwide is estimated to be $2.2 trillion. Corrosion has a huge economic and environmental impact on virtually all facets of the world's infrastructure, from highways, bridges, and buildings to oil and gas, chemical processing, water and wastewater systems and particularly industrial structures. A Centre of Excellence (COE) jointly with industry can help identify the causes and measures to deal with corrosion including awareness generation. It will also facilitate skilling in the sector, thus generating employment.

CIGARETTES

3.4.1. No Increase in Excise Duties on Cigarettes

During the period 2011/12 and 2016/17, while inflation (CPI) has increased by 41% and per capita GDP is up by 62% the excise duty rates have been increased by 118%. Tax increases for cigarettes have been disproportionate over the years and have resulted in a situation that poses challenges on the revenue front as well as the health front. The share of tobacco consumption in duty-paid cigarette form has declined from about 21% in 1981-82 to about 11% currently. The high tax cost of cigarettes has driven the shift in tobacco consumption to illegal, duty-evaded cigarettes and cheaper products (by reason of being lightly taxed and rampant tax avoidance / evasion) like khaini, guthka, bidis and so on.

In light of the fact that the rate increase of cigarette taxes has far outstripped inflation and the consequential fall out on both health (as consumption shifts to products, mostly produced in unhygienic conditions) and revenue fronts, it is

recommended that any proposal to increase cigarette taxes further be considered judiciously and kept in abeyance for the time being. Such a move will also provide the legitimate industry an opportunity to optimise government revenue.

3.4.2. Continuation of Length Based Specific Duty Structure of Excise for Cigarettes

Continue with the existing multiple length-based Specific Excise Duty Structure to aid the legitimate domestic industry in offering its products across socio economic strata of the society and, thereby, widen the base of tax efficient tobacco consumption.

3.4.3. Arrest the Unbridled Growth of Domestic Illegal Cigarettes

Growth of Illegal cigarettes may be checked by measures such as:-

Introducing a new length segment of 'less than 60mm length' with an excise duty of Rs. 200 per thousand cigarettes, and

Reducing the rate of Central Excise duty on the 65 mm filter cigarette slab from the existing level of Rs.1585 per thousand cigarettes to the earlier level of Rs.689 per thousand cigarettes.

Impose Physical Control procedures on all cigarette manufacturing units in the country in order to ensure that there are no avenues for leakage of government revenue through tax evasion.

3.4.4. Tax all Tobacco Products in a comparable way

In order to ensure sustainable tax buoyancy from tobacco it is recommended that the tax base is widened by bringing in the large unorganised segment of the tobacco sector into the tax net, and the large differential in central excise rates between cigarettes and other tobacco products reduced gradually. Registration of all manufacturers of tobacco products must be made compulsory.

3.4.5. Excise Duty on Cigarettes used Captively for Quality Testing

Currently excise duty is applicable on all cigarettes which are used in non-destructive quality testing. Innumerable disputes have arisen with the Department on what machine tests are destructive. Further, costs have also increased by way of duty paid on cigarettes used in non-destructive quality tests. Since these tests are necessary to ensure quality standards of the finished goods, full duty exemption to cigarettes used for quality testing purposes should be provided.

3.4.6. Paper Rolled Biris

In order to evade high excise duty that is payable on cigarettes, certain smoking products masquerading as "Paper Rolled Biri" have mushroomed in the market. These products are claimed to be hand-made and are sold at about Rs 0.25 paise per stick. They look and smoke like regular cigarettes and are sold in packages which are also very similar to cigarette packages and yet they are claimed to be Biris and therefore escape all taxes that are payable on Cigarettes. Currently Paper Rolled Biris are classified under 2403 19 29 as "Biris – Others".

A Chapter Note in Chapter 24 of the Central Excise Tariff should be inserted to clarify what constitutes a Biri and how the so called "Paper Rolled Biri" is to be classified. It is suggested that for this purpose reliance is placed on the definition of biri as stated in the Indian Standards (IS) 1925:1992. The Chapter Note must also clarify that a product comprising of tobacco wrapped in paper must be classified as "cigarettes". A suggested draft of the Chapter Note is given below.

> *"Biris shall be either conical or cylindrical in shape and only consist of biri tobacco mixture and the wrapper leaves to hold the contents. Any smoking product comprising of tobacco wrapped in paper, with or without filter, will be classifiable as cigarette."*

It is recommended that paper rolled biris be classified as cigarettes and appropriate excise duty based on length be imposed.

CIVIL AVIATION

3.5.1. Issuance of Tax Free Infrastructure Bonds

To facilitate the private airport operators to raise funds, it is recommended that they should also be allowed to issue tax free infrastructure bonds to the public. Further, the investments in these bonds should be notified for the purpose of claiming deduction under Section 80CCF of the Act by restoring section 80CCF in the Act. The deduction limit under section 80CCF of the Act for investment in infrastructure bonds should be increased from Rs. 20,000 to Rs. 50,000.

3.5.2. Support Services of Airport to be termed as Infrastructure

In the airport sector, there are many ancillary/support services and facilities required which are essential for smooth functioning of airports. These include fuel facility, parking, cargo facilities, ground handling etc. No airport can function in the absence of these facilities as these are life line for airport.

In the absence of clear definition of 'Airport' under the current Section 80-IA of the Act, it leaves an ambiguity whether these facilities are entitled to benefit of Section 80-IA of the Act or not. FICCI recommends that benefit under Section 80-IA of the Act be extended to cover these facilities as well.

3.5.3. Other Tax Issues

(a) Section 72A of the Act be amended to extend the benefits therein to the entire airline industry and not only to public sector companies with a view to provide the private airline operators a level playing field as well as sustaining the current growth of the civil aviation sector.

(b) Tax incentives for development of Maintenance, Repair and Overhaul ('MRO') facility in India be provided. It will help airlines to reduce cost of repairs presently carried overseas and will also develop India as a hub for such facility.

(c) It is recommended that bonds issued by infrastructure companies should also be made eligible for deduction under section 54EC of the Act.

3.5.4. Exemption from Customs Duty for X-ray Baggage Machine and other Security Systems

Vide entry No.382 of notification 21/2002 – Customs dated 1st March, 2002 - X-ray baggage inspection system and parts thereof are eligible for nil basic customs duty subject to fulfilment of condition that import should be by Government or its authorized person for anti-smuggling or by CISF, Police Force, Central Reserve Police Force, National Security Guard (NSG) or Special Protection Group (SPG) for bomb detection and disposal.

Import of x-ray baggage inspection system at Airports is for security purpose and security is sovereign function (Reserved Activity) as per State Support Agreement (SSA) with Ministry of Civil Aviation (MoCA) and import cost is met out of Security Component of Passenger Service Fee. However, since import is not directly undertaken by the above specified agencies but by respective Airport operators, duty concession is not available though money is being paid out of funds of Government of India (GoI). Hence, this condition needs to be amended to expand its scope to cover other security systems also and to incorporate import by respective Airport operators subject to certificate from Government (MoCA). This concession should not be limited to x-ray machines alone because there are other machines, which are used for bomb detection and disposal. Other Security Systems are as follows:

X-ray baggage inspection system and parts thereof; Explosive detectors; Bomb/suspect luggage containment vessels/ units.; Robots for handling of bombs or suspected baggage; Parameter security intrusion system and accessories; Access Control System; Hydraulic bollards; Boom barriers; Cameras for CCTV.

All the above systems are bought as per specifications laid down by Bureau of Civil Aviation Security (BCAS), MoCA, and GoI.

3.5.5. Inclusion of MRO in the Negative List of Services

As per charging section 66B service tax is levied on the value of all services, other than those services mentioned in negative list. Therefore by virtue of section 66B Maintenance, repairs and operation i.e. MRO Services for aircraft have become taxable.

Indian MRO industry is in its Initial phase needs support for creating level playing field and competiveness with MRO Hubs situated in Singapore, Sri Lanka, Dubai, since Aircraft sent overseas are not liable to Service tax and hence it creates distortion detrimental to the growth of Indian MRO Business.

Either MRO services should be included in negative list of service under Section 66D of finance Act or exemption should be provided.

EDUCATION

3.6.1. School Education

A. Use central funds strategically to spur policy reform in states

Create a Rs. 1000 crore 'State Policy Reform Fund' to incentivise states that implement measures such as merit-based headmaster selection, transparent process for teacher recruitment, allotment and transfers and merit-based teacher promotions

B. Education quality and capacity building of existing institutions

Set up new specialized research and training institutes with focus on areas such as standardized assessments, school leadership, early literacy & numeracy, pedagogy etc. These should be set up as autonomous bodies such as the National Skill Development Corporation and a corpus of Rs. 200 crore to be allocated for this purpose.

C. Strategic initiatives such as assessments, ICT and teacher/ headmaster development

Increase investment on student learning assessment surveys from the current Rs. 12 crore to Rs. 100 crore so that states have sufficient funds for instrument development and implementation, dissemination of results across stakeholders and training of functionaries in the use of assessment data for designing quality improvement interventions.

Further, increase 50 per cent spending on the teacher education scheme as this is critical for strengthening teacher education institutes across states.

3.6.2. Higher Education

A. Provide Tax break to corporates which nominate their employees for higher education either through the continuing education model or a full time program. The fees paid by corporate for employees' education should qualify for investment in human resources and hence exempted for tax purposes. All such investments should be considered as "Investments in Building National Wealth", and hence eligible for 200% investment allowance for income-tax purposes.

B. All donations (and not just restricted only to research funding) to qualified Higher Educational Institutions should be eligible for 200% tax deduction

C. New or existing educational institutions making a fresh investment of Rs. 75 crores or above should be eligible for a preferred and long term Loan facility with interest rates at par with Base Rates or Prime Lending Rates of the commercial banks or financial institutions and for a tenor of up to 15 years with step up repayment plan.

D. Provide a tax relief to the tune of 50% to Universities/Higher Educational Institutions that spend on the capacity development and training of their staff.

E. Higher Educational Institutions should be free to set up campuses overseas freely and a line of credit of at least $500m should be set up by the Exim Bank, as a part of India's diplomatic efforts and use of soft power

F. Tax break to corporates which nominate their employees for higher education either through the continuing education model or a full time program. The fees paid by corporate for employees' education should qualify for investment in human resources and hence exempted for tax purposes.

G. As colleges fees have increased tremendously income taxpayers should be allowed a deduction against gross total income up to a minimum of Rs 1,00,000 per child for fees paid to a higher educational

FINANCIAL SERVICES

I - INSURANCE

3.7.1. Issue of Allowability of the Expenditure under Rule 5 of the First Schedule of the Income Tax Act

The computation of income from insurance business is governed by section 44 of the Income Tax Act read with Rule 5 to the First Schedule of the Act. As per Rule 5, the profits and gains of any business of insurance other than life insurance shall be the profits before tax as per the financials prepared in accordance with applicable regulations issued by the Insurance Regulatory and Development Authority (IRDA) subject to the following adjustments:-

a) Subject to other provisions of this rule, any expenditure or allowance (including any amount debited to the profit and loss account either by way of a provision for any tax, dividend, reserve or any other provision as may be prescribed) which is not admissible under the provisions of sections 30 to 43B in computing the profits and gains of business shall be added back;

b) (i) any gain or loss on realization of investments shall be added or deducted, as the case may be, if such gain or loss is not credited or debited to the profit and loss account;

c) Such amount carried over to a reserve for unexpired risks as may be prescribed in this behalf shall be allowed as deduction.

Even though Rule 5(a) explicitly sustains the disallowances under section 28 to section 43B of the Act for insurance companies, it is silent about the unstated corollary to these sections. The unstated corollary in this context would be allowance of the same set of disallowance in the following assessment years on account of payment of taxes, cess [section 40(a)(ia), section 43B] etc. This would essentially prevent permanent disallowance in the hands of the assessee. However, the Mumbai ITAT in a ruling in the case of New India Assurance Co. Ltd. [2011] 133 ITD 131 (Mumbai) has applied the 'Rule of literal interpretation' at the time of interpreting the statute stipulated for insurance companies vide section 44 of the Act read with Rule 5 of the First Schedule. If one applies the rule of literal interpretation to Rule 5(a) as per this ruling, then the only allowances permitted to be made from the income of insurance business would be those permitted under Rule 5(c). Literal interpretation would deny rightful deduction of expenses in future years under section 43B and 40(a)(ia) of the Act. Such a denial leads to permanent disallowance which could not have been the intention of the Legislation.

It is recommended that Rule 5(a) may be amended to specify that where sections 28 to section 43B provide for deduction of expenditure or allowance in future years pursuant to fulfilment of conditions laid down under such sections, the assessee should be eligible to such deduction subject to fulfilment of such conditions.

3.7.2. Period of Carry Forward and Set-off of Losses in Case of Insurance Business

The insurance industry has a long gestation period and it takes a long time to achieve a break-even. Accordingly, the limit of 8 years for carry forward and set off of business losses is not sufficient. Considering the importance of Insurance Sector for the Indian economy, it should be allowed to carry forward and set-off unabsorbed business losses for an indefinite period.

3.7.3. Enhanced Deduction of Life Insurance Premium under Section 80C of the Act

Section 80C of the Act basically provides for a deduction up to Rs 150,000 for investments made in various savings instruments such as mutual funds, bank deposits along with long term savings in life insurance plans, pension plans, etc. Various other expenditures like tuition fees etc have also been included. Due to such inclusion, share of investment for allowable deduction is reduced to large extent. In order to encourage growth in the life insurance segment it is recommended that the Government should increase the limit of deduction for life insurance premium/by creating a separate limit for deductibility of life insurance premium to the extent of Rs. 200,000 along with an overall enhancement in the investment limit under section 80C of the Act to at least Rs. 300,000.

3.7.4. Deduction in Respect of Insurance Premium

Presently, deduction under Section 80C of the Act is available for payments made for life insurance premium and deduction under Section 80D is available for payments for medical insurance premium. On similar lines, it is suggested that premium paid for personal accident policy, home insurance and travel policy should be allowed as deduction to the policy holders.

3.7.5. Taxability of Re-insurance Premiums earned by Foreign Re-insurers

An Indian insurance company can avail re-insurance with either an Indian re-insurance company or a foreign re insurance company. The Act does not contain specific provisions for taxability of foreign re-insurance companies. CBDT has issued Circular No. 35 of 1956 dated 3 September 1956 in respect of taxability of a foreign company engaged in re insurance with Indian companies. The aforesaid circular states that no uniform principle could be laid down which will be applicable in all cases and that the taxability would need to be determined based on facts and circumstances of each case. The re insurance premiums earned by foreign re insurers from Indian insurance companies are in respect of re-insurance agreements which are concluded outside India. Further, the source of income for the re insurers is their financial assets and risk taking capacities which are entirely located outside India.

However, the tax authorities have in some cases, adopted a contrary view and concluded that the presence and activities of group entities in India rendering services to the foreign re insurer constitute a PE for the foreign re insurer in India. Moreover, in the recent past, the tax authorities have in the case of some foreign re insurers initially taken a view that ceding re insurance premium is taxable in India as the ceding Indian insurance companies constitute a dependent agent PE of the foreign re insurer in India. Accordingly, payments made by Indian insurance companies to foreign re insurers are disallowed due to reason of non withholding of taxes.

In addition to the above, the Insurance Regulatory and Development Authority of India (IRDAI) has also issued a separate set of Regulation permitting foreign reinsurers to set-up branch offices in India to carry out re-insurance business. However, the provisions of the Act per se do not provide for the mechanism in which foreign reinsurers are required to offer their income to tax in India.

In order to allay the apprehension of foreign re insurers, it is recommended that clarity be provided on:-

— Taxability of reinsurance premium where the foreign reinsurer has a branch office in India

— Taxability of reinsurance premium where the foreign reinsurer does not have any presence in India

— Non-applicability of withholding tax provisions with respect to payments made by Indian insurance companies to foreign reinsurers.

3.7.6. Adjustment of TDS in case of Free Look Cancellations

Insurance Regulatory and Development Authority (IRDA) allows policyholders to cancel the policy during the free look period (currently set to 15 days). In case of cancellations during free look period, the commission income accrued/paid to agents needs to be reversed/ recovered. It should be provided that taxes that were already deducted under section 194D of the Act and paid to the Government Treasury on the commission amounts, which no longer would be payable on account of free look cancellations, should be allowed to be adjusted in meeting the subsequent TDS liability of the insurers or alternatively, a mechanism should be laid down for claiming refund of such excess TDS deposited. A plain reading of section 194D of the Act suggests that TDS has to be deducted on the entire amount credited to the agent's account and not to the net amount (i.e. agent's commission adjusted with subsequent debits such as for free look/ cancellation of any policy). CBDT Circular No.120 dated 8 October 1973 clarifies that TDS has to be effected on the gross credit/payment and adjustment is not permissible. A suitable amendment in section 194D of the Act would align the TDS provisions with the service tax provisions.

3.7.7. Enhance Threshold Limit for TDS on Insurance Commission

The threshold limit for deduction of tax at source under section 194D of the Act may be increased to Rs. 100,000. Most of the life insurance agents are in a low income bracket and increase in the threshold limit will result in less administrative burden on the tax department in processing refunds and also result in the agents having more disposable income. Further, the requirement of issuance of TDS certificate under section 194D of the Act on a quarterly basis may be dispensed with and may be allowed to be issued on yearly basis as done under section 192 of the Act.

3.7.8. TDS on Policyholders' Pay-out

Section 194DA of the Act was introduced vide the Finance Act (No 2), 2014, for applying TDS on policyholders pay-out where amount exceeds Rs 1 Lakh. This Section should be repealed as it is detrimental to the insurance business. The low threshold of Rs. 100,000 not only increases the compliance burden for insurers but also causes small taxpayers and persons not requiring to otherwise file the tax returns to do so for claiming of refunds. This is ideally not desirable. The threshold limit of Rs 1 Lakh under Section 194DA should be enhanced in line with the basic exemption limit applicable to individuals. Also, clarity is required on the following issues:-

a) Whether Section 194DA of the Act would apply to other products issued by insurance companies as permitted by IRDS such as health insurance policy, pension plan, group insurance policy like gratuity, superannuation etc.?

b) Whether Section 194DA of the Act would apply to reversionary bonus and terminal bonus, where bonus gets converted into premium?

c) What would be treatment in case of partial surrender of policy?

II - NON BANKING FINANCIAL COMPANIES (NBFCs)

3.7.9. Exclusion of Interest paid to NBFC from the Provisions of Section 194A of the Act

NBFCs have to face severe hardship in terms of collection of TDS certificates from their customers whose numbers run in thousands. Therefore, payment of interest to NBFCs (including those which have been accorded Public Financial Institution status) should be excluded from the purview of provisions of Section 194A of the Act and tax collections through NBFCs should be made by way of advance tax. This will provide level playing field to NBFCs similar to banking companies, LIC, UTI, public financial institution etc., which are also exempted from the purview of this Section.

3.7.10. Deduction under Section 36(1)(viia) be extended to Housing Finance Companies

Section 36(1)(viia) of the Act provides for deduction in respect of provisions made by specified entities in respect of Doubtful Assets based on the prudential norms as prescribed by the Reserve Bank of India. As per the amendment made by the Finance Act, 2016, the provisions of this section are also made applicable for NBFCs. However Housing Finance Companies, registered with the National Housing Bank (NHB) - a subsidiary of Reserve Bank of India, are not covered by provisions of the same section. It is pertinent to note that such companies are subject to similar prudential norms. This creates a disparity in the treatment of the doubtful assets between NBFCs and Housing Finance Companies even though the risk element is the same and the business models and the regulations are similar. It is recommended that the provisions of section 36(1)(viia) of the Act may also be made applicable to Housing Finance Companies registered with NHB.

3.7.11. Treatment of Recognition of Income

Section 43D of the Act recognises the principle of taxing income on sticky advances only in the year in which they are received. This benefit is already available to Banks, Financial Institutions and State Financial Corporations. In accordance with the directions issued by the RBI, NBFCs follow prudential norms and like the above institutions are mandatorily required to defer income in respect of their non-performing accounts. It is accordingly recommended that the provisions of Section 43D of the Act should also be made applicable to NBFCs registered with RBI.

3.7.12. MAT not to apply on Statutory Reserves, NPA etc. created by NBFCs

A NBFC is statutorily required to transfer certain amount towards special reserve, debenture redemption reserve, create provision towards Non Performing Assets (NPAs) in accordance with the RBI Act and guidelines issued by RBI. The amount transferred towards these statutory reserves and provisions strictly does not fall within the purview of adjustments contemplated under 115JB of the Act. Accordingly, it is recommended that it should be explicitly clarified that the amount transferred towards such reserves and provision is not to be added back for the computation of book profits of NBFC under section 115JB of the Act.

3.7.13. Deduction under Section 80C for Deposits placed with Housing Finance Companies

Section 80C(xxi) of the Act allows deduction on term deposits placed with a scheduled bank by an individual for a period of not less than 5 years. However, the deposits placed by the retail investors with Housing Finance Companies are not considered for deduction under section 80C of the Act. It is recommended that a similar deduction under section 80C of the Act be allowed in respect of deposits placed with a Housing Finance Company.

III - BANKING

3.7.14. Deduction on contribution towards Recognized Provident Fund/Superannuation Fund

The limit of 27% prescribed under Rule 87 of the Income Tax Act in respect of employer's contribution to a fund should be done away with for entities administering defined benefit schemes of pension, the terms of which are duly approved by the Government and the banks be permitted to contribute full amounts to the pension/superannuation fund as per the actuarial valuation.

3.7.15. Provide Exemption on Deduction of Tax at Source on Income of Banks

TDS on the income of banks cause considerable inconvenience in view of huge volumes of TDS certificates to be collected by banks for commission received on cross selling etc. Since TDS is only a means of advance collection of tax and banks pay advance tax, it is recommended that banks be granted exemption from TDS under section 196 of the Act.

3.7.16. Provide Exemption on Deduction of Tax at Source on Transfer of Immovable Property

Section 194IA of the Act requires tax to be deducted by a transferee responsible for paying to a resident transferor any consideration (not less than Rs. 50 lakhs) for transfer of immovable property. Exemption need to be provided in cases where transfer is made by banks of properties under the provisions of SARFAESI Act as in such cases the owner is the borrower of the bank and the bank is selling such property to recover its dues. Further, TDS credit is available on such transaction to the owner of the property and not the bank. Accordingly, bank is receiving the consideration net of TDS. This results in reducing its recovery to that extent. In the absence of PAN of such borrower/owner of the property, TDS will be applicable @20%, resulting in substantial amount of reduction in recovery to the Bank.

3.7.17. Extend Provisions of Section 43D to 'Non-Performing Securities'

Section 43D of the Act provides that in the case of a scheduled bank, income by way of interest in relation to prescribed categories of bad or doubtful debts, shall be chargeable to tax in the previous year in which it is credited by the scheduled bank to its profit and loss account; or in which it is actually received by the bank, whichever is earlier. A suitable amendment may be brought into the law to provide that the provision is applicable to non-performing investments as well.

RBI guidelines require interest on non-performing securities to be reckoned as income on realisation basis, whereas for tax purpose it is to be reckoned on accrual basis. The benefit of section 43D may be extended to taxation of non-performing securities as well which would be in line with RBI guidelines.

Further, Rule 6EA of the Rules provides the criteria for determining the prescribed categories of bad and doubtful debts for the purpose of section 43D, which continues to recognize bad and doubtful debts on the basis of 6 month overdue delinquency norms. Rule 6EA should be amended in line with current RBI guidelines which provide for a period of 90 days of overdue delinquency norms to recognise bad and doubtful debts. Section 43D of the Act provides for taxation of interest on bad or doubtful debts having regard to the guidelines issued by the RBI in relation to such debts. Rule 6EA has however not kept pace with the changes with RBI guidelines which creates an issue in the assessment of banks.

3.7.18. Period for Maintenance of Special Reserve under Section 36(1)(viii) of the Act

The existing provisions of Section 36(1)(viii) of the Act provide for a deduction to the banking company in respect of any special reserve created and maintained for providing long-term finance for industrial or agricultural development or development of infrastructure facility in India; or for development of housing in India. The deduction is hence available to special reserve "created and maintained" by the taxpayer. Thus, any amount withdrawn from such special reserve is subject to tax as per Section 41(4A) of the Act in the year of withdrawal. Section 41(4A) of the Act seems to have had an un-intended consequence of retaining the amounts in special reserve account in perpetuity, even long after the purpose of granting the loans has been fulfilled. It is recommended that Section 41(4A) of the Act should be suitably amended to specify a period, say 5 years, for retaining the transferred amounts in special reserve as such a period would be adequate to fulfil the purpose of granting long-term finance.

3.7.19. Threshold Limit for Applicability of TDS on Interest

At present, banks are required to deduct TDS @ 10% in case interest payable on deposits exceeds Rs. 10,000 per year. The limit of Rs. 10,000 was fixed in FY 2007-08 and since then tax slabs have been substantially rationalized. Therefore, it is essential that the TDS provisions be also rationalized. It is recommended that the threshold limit for deduction of TDS on interest other than interest on securities be increased from Rs. 10,000 to Rs. 100,000 where the payer is a banking company.

Rule 31(3) requires quarterly issuance of TDS certificates in Form 16A. It is recommended that TDS certificate in Form 16A should be allowed to be issued on annual basis as in the case of Form 16.

3.7.20. Other Suggestions

— Provisions made by banks for bad and doubtful debts and diminution in the value of investments allowed in terms of RBI guidelines should also be allowed as a deduction in computing book profits for the purpose of section 115JB of the Act.

— Exemption from deduction of tax at source in case of income earned by a person which is exempt by virtue of Section 10(26) of the Act be specifically provided in the Act.

— Allow annual issuance of TDS certificate (Form 16A) as in case of Form 16.

— As per Section 9(1), if a resident makes an interest payment to a non-resident, the said income will be deemed to accrue or arise in India. As per Section 160 the payer will become a representative assessee for the beneficiary and be liable for all his Indian tax compliances with respect to that income. Since Rupee Denominated Bonds will be listed and traded and there will be a large investor base, the issuer will not be in a position to control the various investors to the bonds. It is recommended that the income in respect of rupee denominated bonds scheme be exempted from the provisions of section 160 of the Act.

HEALTHCARE, MEDICAL EQUIPMENTS AND DEVICES

I - HEALTHCARE

3.8.1. Healthcare

India's healthcare infrastructure is lagging behind when compared with other developing countries. There exists a huge gap between demand and supply of healthcare infrastructure facilities available in the country. Therefore, it is imperative to create a conducive environment for facilitating investments into the sector. Following measures are suggested to improve the healthcare of citizens:-

With the huge impact on NCD'S (Non-communicable diseases) on the Indian population it is absolutely imperative to increase the focus on prevention and preventive healthcare and increase relief in medicine cost.

The suggestions are given below:-

(i) Preventive Health Check-ups

Tax exemption on preventive health check-up should be raised from the current Rs. 5,000 to a maximum of Rs. 20,000 under section 80-D of the Act.

(ii) Increase the Tax Exemption on Medical Expenses

The current tax exemption limit of Rs. 15,000 per annum towards reimbursement of medical expenditure by the employer is inadequate in comparison with the medical expenses incurred by the taxpayer and needs to be increased to at least Rs. 50,000 per annum.

(iii) Long Term Financing Option for Healthcare Sector

Healthcare was included in the harmonized master list of Infrastructure sub sectors by the Reserve Bank of India in 2012. This includes hospitals, diagnostics and paramedical facilities. Also, IRDA has included healthcare facilities under the social infrastructure in the expanded definition of 'infrastructure facility'. In spite of this, long term financing options are still not available for healthcare providers. We understand that lending is an issue that the Health Ministry does not play a role in. However, we would request the government to resolve this logjam with the Finance Ministry and Financial Intuitions. This will channelize funds from the banking sector to creating necessary healthcare infrastructure and enabling development of innovative long term financing structures for

healthcare providers. It will also help in creating an attractive environment for domestic production of medical equipment, devices and consumables while also catalyzing research and development. Also, the savings that accrue to hospitals could be ploughed back to expand hospital bed capacity and facilities which would assist in improvising the health care facility and the bed to patient ratio in the country.

3.8.2. Other Tax Incentives

(a) Restoration of Weighted Deduction under Section 35AD

Currently, a weighted deduction under section 35AD of the Act in respect of the capital expenditure (other than land/ goodwill/ financial instrument) is available to a taxpayer engaged in building and operating a hospital with at least hundred beds which has commenced its operations on or after April 1, 2012 – 150% of capital expenditure.

However, with effect from April 1, 2017, deduction under section 35AD of the Act is restricted to 100% of the expenditure only. It is recommended that the weighted deduction available to a taxpayer engaged in building and operating a hospital be restored to help reduce the cost of burden on the patient.

(b) Exemption from Input Service Tax

Clinical Establishments are indirectly being subject to levy of service tax for use of various services which in fact increase the cost of treatment of medical services. Scope of healthcare support services should be expanded to include pathological services, dermatology, infrastructure and logistics support, in order to reduce the input tax.

(c) Tax Incentives

(i) Extend the benefit of deduction under Section 35AD of the Act to a 50 bedded specialty center which is focused on treatment of Non-communicable diseases ('NCDs').

(ii) The healthcare business by its very nature needs to make continuous investments to upgrade existing capabilities. It is imperative to provide for a tax incentive in terms of substantial expansion to upgrade existing capabilities in an existing hospital. It is recommended that the deduction under section 35AD of the Act may be extended to provide benefits to hospital incurring substantial expansion.

(d) Tax Incentives for Specified Activities

Tax incentives may be provided for the following activities:-

(i) Digitization - To boost the 'Digital India' initiative of the government, financial incentives/grants should be provided to institutions that are willing to move towards maintenance of Electronic Health Records (EHR) and Health IT Systems. 250% deduction on investment made for the implementation of EHR should be extended.

(ii) Accreditation - To incentivise hospitals and diagnostic laboratories to undergo accreditation, there should be 100% deduction on approved expenditure incurred for securing accreditation from National Accreditation Board for Hospitals and Healthcare Providers (NABH) and National Accreditation Board for Testing and Calibration of Laboratories (NABL) respectively.

(iii) Remote care - 250% deduction for approved expenditure incurred on operating technology enabled healthcare services like telemedicine, remote radiology etc. should be allowed for improving accessibility, affordability & quality healthcare in remote areas.

II - HEALTHCARE INSURANCE

Direct Tax

3.8.3. Taxation of Insurance Business

The Income Tax Act allows preferred rate of Income Tax to Life Insurance Companies - Section 44, Section 115B and First Schedule of Income Tax Act, 1961. Section 44 specifies method of computation of tax for life insurance companies such that it gives them the advantage of lower rates of tax as compared to other insurance companies. A number of Standalone Health Insurance Companies have started operations over past few years. The business model of these Companies entails large investments and long gestation period. There is however no special relief in Direct Taxes akin to Life Insurance Companies. Standalone Health Insurance Companies are an integral part of the country's healthcare ecosystem and in that sense these are a part of social sector. They are pursuing country's agenda of increased access to healthcare through safety net of insurance

It is suggested that concessions in the form of lower tax rates be extended to Standalone Health Insurance Companies considering that the gestation period is long.

3.8.4. Deduction in respect of Health Insurance Premia - Section 80D

It is suggested that the limit of deduction towards payment of health insurance premiums be increased to Rs 50,000 per annum incentivizing families to seek adequate cover for entire family including parents. The allowance for medical expenditure incurred on senior citizen should be allowed over and above insurance premium allowance and the age bracket should be considered for lowering down to 65-70 years. The expenses on preventative Health check-up should also be allowed over and above the Health Insurance Premium to promote Healthy India.

3.8.5. Taxation of Profits of Health Insurance Companies to be treated as Capital Gains

Under the current provisions, Investment Income of Insurance Companies is treated under the head "Profits and Gains from Business or Profession". The Investment Income of Stand Alone Health Insurance Companies emanates from investment of Shareholders and Policyholders' funds largely into shorter term assets as compared to other Insurance Companies on account of shorter duration of policies. Investment Income to that extent is not really business income.

It is recommended that Investment Income of Stand Alone Health Insurance Companies be treated as capital gains and not as Profits and Gains from Business and Profession.

Indirect Taxes

3.8.6. Service Tax on Health Insurance Premiums

There is a need to incentivize families to avail coverage of health insurance and to prioritize health. This requires lowering of cost of insurance/ cost of premium to increase affordability. Healthcare is currently exempted from Service Tax. Standalone Health Insurance Companies are an integral part of the Healthcare pursuing the national agenda of access to Healthcare.

It is recommended that Health Insurance Premium be exempted from Service Tax.

3.8.7. Point of Taxation ('PoT') for General Insurance Services

With the introduction of the Point of Taxation Rules, 2011 ('PoT Rules') with effect from April 1, 2011, the liability to pay Service tax arises on the receipt of payment or issuance of invoice, whichever is earlier. Insurance Policies have various events, which results in excess payment of Service tax by Insurance Companies, resulting in refunds and adjustments of such excess Service tax.

It is suggested that PoT should be on:

(i) Execution of Policies - Deposits are received with proposal to execute a Policy, however, no Policy is executed and such deposits are refunded to customers

(ii) Receipt of overdue Premium - In case of non-receipt of Premium by the Insurance Companies on the due date (post grace period), the Policy lapses resulting in termination of the Policy (services are discontinued)

III - MEDICAL EQUIPMENTS, IVDs AND MEDICAL DEVICES

3.8.8. Customs Duty on Finished Products

Customs Duty on import of finished products should be prescribed at a very low level while nil customs duty be specified for the import of raw materials / parts / sub-assemblies required for ultimate local manufacturing of instruments / devices and consumables.

3.8.9. Customs Duty on Spare parts

Currently the rate of customs duty on most of the spare parts of medical equipment is higher than the duty rate on equipment. While the basic duty rate on equipment is 7.5%, the basic rate of duty on spare parts is 10%. The compounded duty rate difference is almost above 10%. Since spare parts are used to run the equipment it should be treated like equipment only. The exemption may also be extended to parts, accessories, consumables or assembly components, whether required for manufacturing or to be assembled at site of use. This will remove classification disputes and allow the industry to get the desired exemption.

To ensure that the spare parts imported to be used for maintenance of life saving devices, are used for the same purpose, importer may be asked to furnish “End Use Certificate” within a period of 12 months. A Self Declaration for having consumed the materials in the process of manufacture of Medical Equipment may be specified for the purposes of Customs Notification 21/2010.

The objective of the aforesaid request is to give a fillip to medical device manufacturing in India by making it attractive to FDI from global majors. It is part of an effort to turn India into a manufacturing hub for supplying the medical devices to not just India, but globally. Once investment begins, then this will automatically encompass technology transfer, investment in R&D, development of ancillary industries in addition to financial investment. High tariff barriers will drive away investment, isolate domestic industry and the opportunity will flow to other countries.

Reconsider Duty hikes and their severe impact on the sector: FICCI requests the Government to carry out an impact analysis while trying to fix the customs duty rates. Duty increases should be basis an impact on the society at large especially the poor class and middle class where the medical treatment is diluting their life time savings as increase in duty rates always have cascading effects.

3.8.10. Specific Recommendations

(a) Nil Customs Duty for Medical Cyclotrons: Duty for medical cyclotrons is currently being levied at 26.69%, the same as that for industrial accelerators. Cyclotrons today are listed under one heading in CTH 8543 and by virtue of this notification Medical Cyclotrons do not qualify for the concessional duty benefit which is normally available for Medical Equipment. Just 1 to 2 cyclotrons are being installed every year. Due to the small numbers sold, the revenue impact from duty exemption to the Government would be minimal and duty exemption can fuel increase in investment multi-fold.

Medical Cyclotrons are designed, built and equipped only for medical use for the production of short lived radio isotopes. Radio isotopes are converted into radiopharmaceuticals for diagnosis of cancer through Positron Emission Tomography (PET) studies. Medical cyclotrons cannot be used for any application other than medical / healthcare purpose. In most developed countries the ratio of PET equipment to cyclotron is about 3:1. Currently in India we have around 155 PET/CT scanners being serviced by 16 cyclotrons. As per the Ernst and Young report on Cancer Care 2015, 1 PET system is needed for every million population. This means that India needs to scale up to 1200 units of PET over the upcoming years. Medical Cyclotrons need to be scaled up to around 150 to be able to serve the PET units.

Customs duty for Medical cyclotrons should be made nil to enable imports at cheaper costs so as to provide early cancer diagnosis and thereby save lives through affordable treatment costs.

(b) **Exempt Customs Duty on Blood Glucose Monitoring Strips:** Customs duty on blood glucose monitoring strips is 18.94% for Lancet and control solutions ~25%. In India ~ 70 million people are diabetic. Diabetes patients will have greater risks of developing other health problems, such as heart disease, kidney disease, weakening of vision, nerve problems and aridity of skin. Hence regular monitoring can help spot patterns to try to avoid high and low blood glucose, reduce complications of diabetes, and help control diabetes.

91% patients still do not own a Blood Glucose Monitoring (BGM) device in India. The main reason for this is affordability & intent to pay. As a consequence, these diabetes patients do not test themselves and therefore do not manage their diabetic condition. This 'working class' productive population now becomes a financial and health burden on the country.

India does not reimburse BGM meters and strips, unlike most other countries. Countries like USA, EU, and China reimburse the cost of BGM meters and strips to their patients. The reimbursing bodies do this since they see financial benefits of doing so. The aim is to enhance demographic dividend.

Customs duty for strips should be made duty free to encourage self-testing of blood glucose at affordable cost & to improve quality of diabetic patient's life.

(c) **Reduce Customs Duty on Medical Sterilisers, Biological Indicators and Bio Patch:** Customs duty on Medical sterilizers is 26.43%, Biological Indicator is 24.47% and Bio patch is 17.1%. The Advanced Sterilization Products portfolio enhances patient care by preventing infections in hospitals. This encompasses adopting a trusted role in Operating Rooms, Intensive Care Units, Central Sterile Supplies Departments and Endoscopy units, and by offering a wide range of innovative sterilization and disinfection products. Medical sterilizers, Biological indicators, Bio patch products play a vital role in infection prevention. This also helps to improve efficiency of the hospital with better bed turn over while reducing post-surgery complications. The customs duty on these products is very high and may result into compromised solutions because of the cost & intent to pay.

Customs duty on these Advanced Sterilization Products should be reduced to minimum slabs to improve quality of medical treatment & patient safety.

(d) **Exempt Customs Duty on Neurosurgery Medical Devices:** Customs duty is 18.94% on medical devices used in Neurosurgery. Neurosurgery, Neurovascular and Craniomaxillofacial are vast array of products and solutions to treat patients with stroke, aneurysms, traumatic brain injuries, facial trauma & reconstruction, tumours and other abnormalities related to the brain and face. The development of these technologies requires significant research, investment in terms of time (3-5 years), resources to ensure safety, and quality standards are met and patient outcomes are excellent.

Medical devices like Hydrocephalous shunt, accessories, Cardio-Vascular Clamps, scissors, needle holders, Clips, Applying forceps in Neurosurgery, Diathermy Equipment (Electrosurgical Unit), ICP Monitoring Equipment,

Implants for Neurosurgery, Instrument for Neurosurgery (Microsurgery), Craniotomy (Pneumatic Drills) are used in Cardio vascular neurosurgery.

Medical devices used in Neurosurgery should be exempted from customs duty considering that these products are used for treating critical deformities & in lifesaving procedures.

(e) **Rationalise Inverted Duty on Phaco Emulsification Equipment:** Basic import duty on phaco emulsification equipment and accessories (covered under chapter heading 901850) used in cataract surgeries is 7.5% and CVD is 6%, total duty works out to 18.94%. However spare parts for this equipment are classified under Chapter Heading 903300 with basic duty of 10% and CVD of 12.5% the total duty works out to 29.44%. There is a differential of almost 10% in duty between equipment and spare parts of the same equipment.

This anomaly needs to be removed. It is recommended to reduce the import duty under Chapter Heading 903300 for import of spares of phaco emulsification equipment to appropriate minimum rate.

(f) **Exempt Basic Customs Duty for Diagnostic Equipment, Analysers under Heading 9027:** With abolition of List 37, all diagnostic devices are now covered under Chapter 90 (9027). They therefore attract high duty rates and it is recommended that they be charged to nil duty to encourage access to newer technologies. Diagnostic Instruments are currently being levied with 4% SAD under HS code 90278090. This levy can be eliminated as none of these are manufactured in the Country. This would reduce the overall duty from 17.39% to 13% app. This will help reducing the prices at the consumer level.

It is therefore recommended that Diagnostic Equipment, Analysers falling under heading 9027 should be exempted from customs duties.

(g) All diagnostics equipment may be assessed at NIL duty or with a total duty of 9.63% as sudden reversal and imposing duty of 14.72% makes the cost of these Hi Tech Instruments significantly expensive

(h) **Exemptions for In Vitro Diagnostics**

(i) Automated Identification and Antibiotic System and consumables i.e. products falling under HS Code 38220019 attract a High Total Customs duty of 29.73%. The increasing prevalence of antibiotic resistance is challenging established empirical treatments, making early identification and susceptibility determination more important. To avoid time-consuming overnight cultures, the rapid identification and susceptibility testing helps to detect antibiotic susceptibility and rational use of antibiotics. Rapid and correct diagnostics are a key instrument that enables our healthcare systems to monitor and address the issues of Antimicrobial resistance (AMR). However, the current duty structure for AMR diagnostic solutions is high and has the effect of impeding the adoption of modern, automated solutions, especially in Public hospitals and small cities, towns and villages.

It is recommended to reduce the Basic duty to 5% from 7.5% currently & Countervailing Duty (CVD) to 6% from 12.5% as the items are being used for regular healthcare diagnostic practices.

(ii) Life Saving IVD's like Automated Blood Culture System and Culture Media i.e. products falling under HS Code 38210000:

When a patient shows signs or symptoms of a systemic infection, results from a blood culture can verify that an infection is present, and they can identify the type (or types) of microorganism that is responsible for the infection. For example, blood tests can identify the causative organisms in severe pneumonia, puerperal fever, pelvic inflammatory disease, neonatal epiglottises, sepsis, and fever of unknown origin (FUO).

It is recommended to reduce the Basic duty to 5% from 7.5% currently and Countervailing Duty (CVD) to 6% from 12.5% as the items are being used for regular healthcare diagnostic practices.

(iii) Excise duty for manufacturing of Diagnostics Reagents may be made nil from existing 10% to allow cost benefit to indigenous manufacturer.

(iv) Diagnostics Reagents may be subjected to same levels of duty as Medical Equipment/Devices under Chapter 9018 as against the existing rate of 26.75%

(v) Duty on PCR kits should be made nil as given for ELISA, CLIA Diagnostics kits, etc. from existing 26.75% in order to increase access of diagnosis to patients against the load of deadly viruses/bacteria such as Hepatitis C, CMV, H1N1, TB, etc.

(vi) Exemption for other kits under heading 3822:

Customs Tariff for Diagnostics kits is based on test /technology rather than the Analyte causing anomalies like: ELISA & CLIA kits are exempt from customs duty whereas all other reagent kits are liable for duty under heading 3822 @ 26.75%.

(vii) It is recommended that equipment under heading 90278090 and 84192010 which currently attract total customs duty of 17.56% and 26.69% respectively should be exempted from Customs duty.

(i) Reconsideration of Duty Hikes on medical devices and equipment (Special cases): In Budget 2016 Basic Customs duty was increased from 5% to 7.5% for Medical devices (CTH 9018). Similarly, Special Additional Duty (SAD) @ 4% was also introduced on Medical devices.

It is recommended that following special cases of medical devices and equipment which are elaborated below may be reconsidered for reversal of increased duties to earlier slabs:

(a) Reduce Import Duty on LINACs from 18.94% to 11.64%

In January 2016 the Customs duty for medical linear accelerator (coming under chapter code 90221490) has been increased by almost 7 % and currently being levied at 18.94% which rather contrasts the effort by the Government towards providing affordable medical treatment to all sections of society. Moreover Linear Accelerator is costly equipment with costs ranging between $1 Million to $3 Million and high customs duties have already impacted the hospitals planning to set up cancer care centres in Tier2 and Tier 3 cities. Healthcare Industry feels that the increase in Customs duty was arbitrary and a complete impact analysis was not carried on while increasing the customs duty rates.

The Cancer treatment in India is already unaffordable for a large section of Society and high Customs duty on the product affects the patients' pocket. Developing indigenous technology for advanced high end machine – then going forward it might take at least 7-10 years to be able to develop anything worthwhile as per world standard. The indigenous manufacturing is attempted with the help of know how transfer but only for low energy equipment and is in nascent state.

It is recommended that Customs duty for Medical Linear Accelerators should be completely exempted to encourage and provide impetus to investment towards cancer treatment and therefore saving lives and at affordable treatment costs. The per year installation of linear accelerators in India is also low, the revenue impact to the Government would be minimal but would help regain the imbalance in equipment installed versus patient requiring treatment for this disease.

(b) Reduce Import Duty on Magnetic Resonance Imaging (MRI) from 18.94% to 11.64%

MRI is used for anatomical studies. Tissue characteristics obtained through a MRI help in diagnosis of disorders related to spine, nervous system, musculo-skeletal, stroke, degenerative diseases, cancer to name a few. MRI is non-radiation device and hence can be used even when X-Ray emitting devices cannot be used such as in cases with children and pregnant women.

For a population of 1.2 Billion, only 1400 units are available in India currently. USA with 350 million population has close to 30,000 units. China has around 14,000 MRI units. The already existing gap will further widen as increased duty from 11.64% to 18.94% increases the cost of MRI equipment by up to 70 Lakh Rupees. Investment decisions are being deferred.

Manufacturers are striving to bring MR manufacturing to India as part of "Make in India" strategy. Due to intensive technology and investment, this would take between 2 and 3 years with our best efforts to bring this technology to India. In the meanwhile it would help immensely to maintain the current momentum in supply of MRI making it accessible and affordable.

(c) Reduce Customs duty on Specified Medical Devices from 18.94% to 12.04%

Minimally invasive procedures, which include laparoscopic surgery, use state-of-the-art technology to reduce the damage to human tissue when performing surgery. The advantages of MIS are lesser bleeding, fewer post-op infections, fewer complications, shorter length of stay, quicker return to normal activities, less scarring. This not only benefits the patient but also helps to improve efficiency of the hospital with better bed turn over which is critical especially in a resource constrained healthcare environment like India.

The development of these technologies requires significant research, investment in terms of time (3-5 years), resources to ensure safety, and quality standards are met and patient outcomes are excellent.

Indigenous manufacturing of medical technology in India is currently restricted to only basic medical equipment and can progress to more sophistication only when we have the right duty structure and other policies that foster innovation with focus on patient safety, optimal standards of healthcare delivery and quality.

Staplers, cutters, instruments used for sealing vessels, Trocars in Endoscopic surgery for access, Generator and Cart, Probes, Footswitch, Headpiece etc. are used in Minimally invasive surgeries and deserve a lower rate of customs duty.

(d) Reduce Import duty on Specified Medical Devices and Equipment

CTH	ITEM	Recommended	Current
90183930	Guide Wire & Accessories	5.15%	12.03%
90183930	Devices	11.64%	18.93%
90185090	All Ophthalmic equipment	11.76&	19.13%
90213900	Intraocular Lenses	5.20%	12.15%
90185090	Intraocular lenses Cartridges	11.75%	19.13%

3.8.11. Direct Tax Incentives

(a) Depreciation rate for all medical/ surgical/ pathological equipment (including lifesaving-equipment currently eligible for 40% depreciation) should be increased to 60%, as considering the advances in technology, the medical equipment are getting outdated at a very fast pace.

(b) Any new capital expenditure towards replacement of old machinery/equipment in hospitals, at any time, be entitled to 100% deduction.

(c) Manufacturers of indigenous medical technological products be granted complete tax exemption from MAT.

(d) 250% deduction of approved expenditure incurred on R&D activities related to indigenous development of medical technology should be provided.

IV - LIFE SCIENCES

3.8.12. Weighted Deduction under Section 35(2AB) for computing Book Profits

Presently, while computing the 'book profit' under Section 115JB, the amount of weighted deduction under Section 35(2AB) is not deducted. In order to promote in-house R&D in India, the amount of weighted deduction under section 35(2AB) of the Act should be deducted while computing book profit for the purpose of MAT.

3.8.13. Safe Harbour Rule for Contract Manufacturing

The Central Board of Direct Taxes has notified Safe Harbour Rule covering sector like IT/ITES, KPO and Auto Component manufacturer prescribing desirable margins so that it avoids litigation under transfer pricing regulation.

It is requested to provide similar guidelines for pharma companies that are manufacturing and exporting the product as contract manufacturer.

3.8.14. Clinical Trials - Weighted Deduction under Section 35(2AB)

Weighted Deduction under section 35(2AB) should be enhanced from existing 200% to 250% for a period of next 10 years i.e. up to 31st March, 2024. The current provisions for deduction under section 35(2AB) covers only expenditure incidental to research carried on at the in-house R&D facility. As clinical trials are specialized and expensive most R & D facilities outsource these trials. Hence, in order to successfully launch any new drug, the innovator has to get the clinical trial done outside approved facilities within India & abroad. Therefore all expenditure related to research i.e. clinical trials, bioequivalence studies, regulatory and patent approvals should be eligible for weighted deduction, even if these activities are carried outside the approved R&D facility. Presently, as per DSIR guidelines amount spent by a recognized in -house R&D towards foreign consultancy, building maintenance, foreign patent filing are not eligible for weighted deduction under section 35(2AB) of the Act. DSIR guidelines need to be modified accordingly to allow the above said expenses for weighted deduction under section 35 (2AB).

HOUSING & REAL ESTATE

3.9.1. Deduction of Interest paid on Borrowed Capital

The deduction available under section 24 of the Act is to a maximum limit of Rs. 2,00,000/- for interest on loan taken for acquisition/construction of self-occupied house property. Given the rising interest rates and the increase in property prices and also to spur the demand for housing, it is recommended the exemption should be increased to at least Rs. 3,00,000/- per annum.

Further, deduction in respect of interest on housing loan is allowed only after the possession of the property is handed over to the buyer and the interest payments for the construction period are allowed as deduction over a period of five years, starting from the previous year in which property is acquired or constructed. Therefore, the tax benefit is available to the taxpayer only after three to four years from the date the housing loan was raised by him despite regular interest payments embedded in EMI during the construction period.

To meet the housing need for all, it is desirable that the deduction towards interest on housing loan should be allowed in the previous year in which interest is paid by the taxpayer, irrespective of the year in which the property is acquired or constructed, provided that the house is not sold or transferred within a period of five years from the date of construction/ acquisition.

3.9.2. Taxability of Immovable Property received for inadequate consideration

Section 56(2)(vii)(b) of the Act provides that receipt of immovable property by an individual or HUF for a consideration which is less than stamp duty value of the property by more than Rs. 50,000, will be taxable as income from other sources on the stamp duty value in excess of the consideration. Section 56(2)(vii) of the Act in respect of transfer of immovable property for inadequate consideration was originally inserted by Finance Act, 2009, but later on deleted by Finance Act, 2010 with retrospective effect from date of insertion. There does not seem to be any reason for reintroduction of the same.

The provision levies tax on inadequacy of consideration. Section 50C/ 43CA of the Act deals with such inadequacy in hands of the seller/ transferor. Section 56(2)(vii) of the Act will tax the same inadequacy in the hands of the purchaser as 'income from other sources', where sale consideration is less than the stamp duty of the property by an amount exceeding Rs. 50,000 as stamp duty value less sale consideration. Both, seller and purchaser, pay tax on same inadequacy of consideration and thus, there is double taxation to that extent.

It is recommended that clause (ii) to Section 56(2)(vii)(b) of the Act should be deleted as it will lead to double taxation, which could not be the intended objective of the Government.

Alternatively, Section 50C/43CA of the Act may need to be correspondingly modified to exclude such transaction which has been taxed under Section 56(2)(vii)(b) of the Act.

It is also observed that in the continued sluggish market conditions, this section is a big deterrent for real estate developers as circle rates fixed by the State Government in many cases are higher than the market value or the value negotiated by and between the seller and buyer. It is pertinent to observe here that many State Governments have notified reduction in Circle Rate after review and assessment of ground situation. In consequence thereto, this makes seller and buyer both liable to pay tax on notional gain or profit under the provisions of section 43CA, 50C and section 56(2)(vii)(b) making the case for double taxation. It is recommended that the provisions of these sections be reviewed in light of the actual situation.

3.9.3. Raise the Limit for Deduction for Principal Repayment

In the case of home loan repayments, the ceiling under tax benefits is capped at Rs. 1,50,000/- for principal paid, which is very less, particularly when home loan principal repayments are clubbed with other tax saving instruments. Therefore, the deduction for principal repayment should be considered for a separate/standalone tax exemption, rather than being clubbed under Section 80C of the Act. It is recommended that the rent shown as income in earlier years be made eligible for deduction if the same is not realised.

3.9.4. Taxability of Unsold Flats in the Hands of Real Estate Developers

The issue relates to the addition on account of annual letting value (ALV) of flats, constructed but lying unsold, assessed on notional basis under the head "Income from head House Property" in the hands of real estate developers. Such unsold construed flats as per the specific exclusion provided in Section 22 of the Act would not attract tax under the head 'income from house property' which comes within the purview of exception provided in Section 22 of the Act, in as much as, it exclude the property that an owner occupy for the purpose of his business.

However, the tax authorities have made additions to the income of the real estate developers on account of annual letting value (ALV) of flats, constructed but lying unsold, assessed on notional basis under the head "Income from head

House Property". It has not been appreciated that the real estate developers are not in the business of renting out of flats and letting out vacant or other properties. Thus, such real estate developers cannot be taxed in respect of ALV of flats notionally because they (as owners) are occupants of the flats, and such occupation is limited for the purpose of business, as a builder.

It is recommended that a clarification may be issued by the CBDT to provide that property held as stock-in-trade by the real estate developer for the purposes of its business would not to be assessed to income tax on a notional ALV basis under the head "Income from House Property".

3.9.5. Infrastructure Status to Development of Integrated Townships

An integrated township involves development of residential, institutional, educational, medical, community and commercial buildings etc. In the process of development of an integrated township, apart from development and construction of above establishments, various facilities such as roads, water supply, sewerage system, sanitation, water treatment, electrification, land scaping, solid waste treatment, horticulture and other civic services are required to be created/provided. While according approval, the State Government specifically directs that these development projects including all facilities/services created/ provided therein will ultimately be handed over to respective State Governments/Local Bodies and shall not remain with the developer. These integrated township projects are, therefore, in a way at par with the BOT (Built, Operate & Transfer) projects.

In the light of above facts and in order to motivate the genuine real estate companies to come forward and step into promotion and development of large integrated townships, it is requested that Integrated township development projects be brought within the definition of infrastructure or at least various facilities such as roads, water supply system etc. created after obtaining Government approvals be considered as infrastructure facility for the purpose of Section 80-IA/Section 35AD of the Act and deduction under Section 80-IA or Section 35AD of the Act (as the case may be) be granted to the developers in respect of such infrastructure development.

HYDROCARBON

Direct Tax

3.10.1. Tax Holiday for Exploration and Production Activities Relating to Natural Gas and CBM

To avoid uncertainty, it is important that the Government should clarify that for the eligibility to avail tax holiday under Section 80-IB of the Act, the definition of 'mineral oil' would include natural gas retrospectively irrespective of NELP round and that the benefit should also be available to Coal Bed Methane ("CBM"). In other words, it should be explicitly provided that the term 'mineral oil' will include natural gas and CBM for all past and future rounds of NELP for the purposes of Section 80-IB of the Act.

3.10.2. Treatment of Losses and Depreciation Allowance in Amalgamation or Demerger

Section 72A of the Act needs to be amended so that accumulated loss and unabsorbed depreciation allowance from specified business of laying and operating a cross-country natural gas pipeline network for distribution, including storage facilities being an integral part of such network is allowed to be carried forward and set off in the hands of the resulting company in case of demerger or amalgamated company in case of amalgamation, provided the loss is directly relatable to the undertakings transferred.

3.10.3. Scope of 'Undertaking' for the Purposes of Tax Holiday

The limitation of the tax holiday for oil and gas to a single undertaking based on a single PSC is regressive and inconsistent with the construct of tax holidays for other sectors. This should be amended to define an 'undertaking' (consistent with the judicial decisions) that each distinct field development evidenced by a separate development plan should be an

undertaking eligible for the tax holiday. This is all the more important as the amendment has been made retrospectively and declaring each block as a single undertaking, that too with retrospective effect, will adversely affect the profitability of operators.

3.10.4. Extend the period of Incentive under Section 80-IB(9)

The Finance Act, 2016 has inserted a sunset clause in section 80-IB(9) of the Act to provide that no deduction shall be allowable to an undertaking which begins commercial production of mineral oil or natural gas on or after 1 April 2017. Many companies have acquired blocks under the scheme eligible under section 80IB (9) of the Act by the dates specified in that section. It is well known fact that the discoveries in the blocks take a very long time and the explorers have to conduct discovery exercises for many years before they are successful in obtaining commercial production. The investments in the blocks have been made with the belief that deduction under section 80-IB(9) of the Act would be available once commercial production is commenced. The withdrawal of deduction for the assessees commencing commercial production post 1 April 2017 will put investors of the blocks to a disadvantage. It is therefore recommended that the sunset clause should relate to acquisition of new blocks and for commencing discovery process in such block already acquired. It is further recommended that the sunset clause may not be made applicable for blocks in which the discoveries have already commenced although commercial production may have not commenced before 1 April, 2017.

3.10.5. Definition of 'Infrastructure Facility' to include Exploration and Refining Activities

Definition of 'infrastructure facility' as per Section 80-IA of the Act should be amended to include exploration and refining activities.

3.10.6. Introduce Safe Harbour Rules for LNG Imports

Today, long term pricing for LNG is being replaced by spot prices which are largely determined by a number of instantaneous factors. Nearly 25% of LNG globally is now traded on the spot market. Functions here often involve the identification of potential spot purchasers, agreement with potential counterparties, and range of intermediary logistic services. Further the challenges of accommodation of re-gasification and trading prices, wherein determining safe harbour ad hoc can be extremely challenging. It is recommended that safe harbour rules for LNG imports be provided based on actual dispersion of custom import prices as it will help reduce litigation on transfer pricing of LNG imports.

3.10.7. Deduction under Section 35AD be extended to City Gas Distribution Entities

The benefit of deduction under section 35AD of the Act may also be extended to City Gas Distribution Entities to encourage higher investment in City Gas Distribution Business. Currently, deduction under section 35AD of the Act in respect of capital expenditure for laying and operating a cross country natural gas or crude or petroleum oil pipeline network for distribution including storage facilities being an integral part of such network is allowed subject to fulfilment of following conditions:-

a) such business is owned by a company formed and registered in India under the Companies Act, 1956 (1 of 1956) or by a consortium of such companies or by an authority or a board or a corporation established or constituted under any Central or State Act;

b) has been approved by the Petroleum and Natural Gas Regulatory Board established under sub-section (1) of section 3 of the Petroleum and Natural Gas Regulatory Board Act, 2006 (19 of 2006) and notified by the Central Government in the Official Gazette in this behalf;

c) has made not less than [such proportion of its total pipeline capacity as specified by regulations made by the Petroleum and Natural Gas Regulatory Board established under sub-section (1) of section 3 of the Petroleum and Natural Gas Regulatory Board Act, 2006 (19 of 2006)] available for use on common carrier basis by any person other than the assesse or an associated person;

d) fulfils any other condition as may be prescribed.

City Gas Distribution business involves a lot of capital investment before commencement of operations. Steel as well as PE network is required to be laid for supply of CNG to Vehicles and PNG to Domestic Households. The Government is also focussed to provide more and more number of domestic household connections to phase out LPG Subsidy. City Gas distribution entities are duly authorised by Petroleum and Natural Gas Regulatory Board (PNGRB) to lay, build and operate City Gas Distribution Network in various cities. It is accordingly recommended that capital expenditure incurred by City Gas distribution entities to lay, build and operate City Gas Distribution Network be made eligible for deduction under section 35AD of the Act. This will provide a big push in business of City Gas Distribution Network.

3.10.8. Non-Use of Secret Comparables for Pricing of LNG

Determination of LNG pricing is highly complex, due to international price changes, varying cost of intermediary logistic services etc. Thus, secret comparables obtained from corporates are usually far from accurate and hence should not be applied for determination of arm's length price of LNG. Allowing use of secret comparables for non-commodities leads to a high number of disputes and unwarranted litigation. Developed countries, such as the US & UK have an official policy of not using secret comparables for any Arm's Length Principle (ALP) evaluation. It is recommended that secret comparison analysis should not be made applicable for non-commodities like LNG.

3.10.9. Extension of Section 42 to investment in Foreign E&P Blocks

Section 42 of the Act is a special provision for computing the profits or gains of any business consisting of prospecting for or extraction or production of mineral oils. It provides for specific deduction subject to the satisfaction of following cumulative conditions:-

– Expenditure by way of infructuous or abortive exploration expenses in respect of any area surrendered prior to the beginning of commercial production by the assessee;

– Companies have entered into an agreement with the Central Government for extraction or production of mineral oils; and

– Such agreement has been laid on the table of each house of Parliament.

The word *"surrendered"* in the section precludes allowability of deduction for expenditure incurred in an area which cannot be surrendered due to practical constraints. It is therefore suggested that the word *"surrendered"* may be deleted from section 42(1)(a) of the Act or the word *"surrendered"* may be replaced with the term *"relinquished in full or in part"*.

Accordingly, as per Section 42 of the Act, deduction is not allowed for expenditure incurred by Indian companies for prospecting or extraction or production of mineral oils from oil and gas blocks situated abroad.

It is suggested that Section 42 of the Act be amended to remove the aforesaid conditions so as to enable Indian companies to claim specific deduction of expenditure incurred on oil and gas blocks situated outside India.

3.10.10. Exemption from MAT

Oil exploration and production companies should be exempted from the purview of Section 115JB of the Act to promote the domestic exploration and production. This will reduce import dependence of the nation.

3.10.11. Remove Ceiling on Profits for Site Restoration Fund (SRF) Contribution

Abandonment and site restoration of oil and gas installations are significant part of the project life cycle in the E&P sector. This phase involves huge capital outlay and has considerable environmental implications. Section 33ABA of the Act provides for tax deduction on contribution to the Site Restoration Fund (SRF) subject to a ceiling of 20% of the

profits from the business. This ceiling could result in a situation where the assessee is unable to claim full deduction for the amount deposited in the SRF in the absence of sufficient profits. It is, therefore, recommended that the deduction should be based on full contribution without any ceiling on profits.

3.10.12. Deduction for Expenditure on Prospecting for certain Minerals

As per the provisions of section 35E of the Act, expenditure incurred by a resident in India engaged in operations relating to prospecting for or extraction or production of minerals is allowed as deduction over a period of 10 years commencing from the year in which the commercial production of the mineral commences. The deduction under this section is allowed only in respect of revenue expenditure. The allowability of deduction only in respect of revenue expenditure, that too in a long span of 10 years, goes against the development of mineral industry in India. The prospecting of minerals involves huge expenditure both in terms of revenue and capital, therefore, it is recommended that 100% of revenue expenditure should be allowed in the year of incurrence of the expenditure.

3.10.13. Allow Setting off of Losses of Specified Business from Profits of other Businesses

The losses from the specified business (laying and operating a cross country natural gas or crude oil or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network) under Section 35AD of the Act should be made eligible for set-off against profits from other businesses of the taxpayer, and not restricted to be set-off against only the specified businesses as per section 73A of the Act.

Indirect Taxes

3.10.14. Zero Customs Duty for new Refineries/Refinery Expansions and other Imports

Zero customs duty should be introduced for the capital goods imported for the new refineries as was extended to RPL Refinery, instead of the current rate of duty of 22.85% so as to provide a level playing field to the new refineries of the PSUs. It is also suggested that the Customs duty on import of material viz. pipes, valves, flanges, data communication system for laying of petroleum products and gas pipelines is made nil.

Further, CENVAT credit is unavailable for pipeline projects on the ground that manufacturing activity is not carried out even for crude pipelines. With a view to facilitate investments in the petroleum sector, particularly in petroleum infrastructure it is requested that the basic customs duty on project imports should be reduced to nil for crude, petroleum products and gas pipelines for developing LNG regasification/ CNG / auto LPG infrastructure and Floating Storage and Regasification Units.

3.10.15. Customs Duty on LPG for Non-domestic use cleared from Common Storage Tanks

Customs duty on import of LPG/Butane/ Propane for Domestic PDS purposes has been made 'Nil' vide Notification No. 37/2005 dated 02/05/2005. At port locations indigenously produced LPG as well as imported LPG is stored in common storage tanks in commingled condition since irrespective of the source, the BIS specification of the product is same. Though LPG is primarily used only for domestic PDS purposes, some minor quantity of LPG is also required for non-domestic purposes. Differential Excise duty is duly deposited for such use by the refineries. LPG plants are duty paid locations and there is no mandatory requirement of maintaining stock records as per FIFO basis for receipts and dispatches.

Customs authorities however have initiated proceedings under the Customs Act on the ground that on the basis of FIFO system some portion of the Imported LPG is also being used for non-domestic purposes and the exemption extended for imports is not applicable, therefore appropriate Customs duty should also be paid for such use in spite of Excise duty having been deposited.

Appropriate clarification should be issued to confirm that since the locations storing LPG are duty paid locations storing imported as well as indigenous LPG in common tankages, there should be no requirement to pay any Customs duty for

LPG used for non-domestic purposes as long as there is sufficient indigenous product available at the given time for such use on which appropriate Excise duty is paid.

3.10.16. Exemption from Payment of Customs Duty on Import of Liquefied Natural Gas (LNG)

LNG is a clean fuel and mainly used in fertilizer and Power sector. Recognizing the shortage of gas, Government has encouraged import of LNG. Since LNG falls in the same logical category as Crude Oil, they must have the same level of taxation as applied to Crude Oil. The benefits of using LNG are far-reaching vis-a-vis the revenue loss to the exchequer. International LNG prices are at least 20-25% lower than the Crude Oil (or petroleum fuels) on heat equivalent basis and thus, reduces the cost of energy to end-consumer in addition to the Forex saving.

Since customs duty on crude oil has already been made zero, import of LNG presently attracting 5% Customs duty should also be exempt. Through Finance Act 2012, Government has exempted levy of Customs duty on import of LNG for Power Sector. However, this exemption should be extended to other sectors also.

3.10.17. CENVAT Credit on OIDB Cess on Crude

Presently Crude oil produced in the exploration blocks attracts OIDB cess at the rate of Rs. 2,500/- per MT. Since cess is a duty of excise, CENVAT credit should be extended for this cess also.

3.10.18. CENVAT Credit on National Calamity Contingency Duty (NCCD)

Presently NCCD (National Calamity Contingency Duty) of Rs.50/MT is payable on the indigenous as well as on the imported crude. Even though the same is cenvatable, it can be set off only against payment of NCCD, making the CENVAT credit virtually Nil both to the producer and consumer of crude. NCCD should be made cenvatable against the duty on the finished petroleum products.

3.10.19. Exemption to the Supply of goods under International Competitive Bidding Contracts

Customs Notification No. 12/ 2012 and Excise Notification No 12/2012 provide an exemption from the supply of goods affected under International Competitive Bidding (ICB) for specified purposes, subject to the fulfillment of specified conditions. The term ICB is not defined under the Customs or Excise Notifications, Act, Rules. Thus, it is a very subjective area of interpretation as to whether the supplies of goods are made under ICB or not?

Generally, when international players are permitted to bid on a contract and a suitable advertisement is issued to this regard in a national/international newspaper etc., this should be sufficient to construe that the supply of goods is effected under the ICB. However, in the absence of any guidelines on this matter, field formation is denying the benefit of exemption of supply of goods under ICB stating various reasons such as:

- A proper advertisement was not issued in a national or international newspaper etc. or even if the advertisement is issued, the term ICB is not mentioned in advertisement
- Proper procedure of Request for Proposal and Bidding was not followed
- Selection of respective participants was not done in the specified manner
- Contract was issued to local vendor even though the foreign vendors were only eliminated at the bidding stage
- Extension of contract awarded in continuance of an earlier contract issued under ICB cannot be construed as supply of goods made under ICB

The intention of the legislature seems to allow the benefit when the foreign players are competing with Indian players. Thus, the bid inviting/permitting to tender/bid by a foreign and Indian player should be construed as ICB and thus, the benefit of exemption should be extended to all such contracts.

It is requested that a Circular is issued by the CBEC to clarify the necessary conditions to be fulfilled for a contract to be construed as ICB compliant contract.

3.10.20. Service Tax on "Royalty" and "Profit Petroleum" for E&P Companies

The Finance Act, with effect from 01.04.2016 levies service tax on services provided by the Government or a local authority at effective rate of 15%. CBEC vide circular no. 192/02/2016 dated April 13, 2016, clarified that periodic payments in relation to any natural resource shall be taxable – e.g. Spectrum User Charges (telecom), monthly payments with respect to the coal extracted from the coal mine or Royalty payable on extracted coal. This has resulted in ambiguity of coverage of periodic Royalty and other payments in oil and gas (O&G) sector, needing urgent clarification. O&G companies are, in terms of Production Sharing Contracts ("PSC") and the Oilfields (Regulation and Development) Act, 1948, obliged to pay the Government Royalty and Profit Petroleum (Government share of Profits) on mineral oil produced. The Circular has brought in ambiguity as to taxability of Royalty and other payments made to the Government, which for the following principles/reasons is not a service, and not liable to Service Tax:

- Payout is for statutory function of the Government: Royalty is statutorily required and regulated. Thus, being pursuant to statutory function, Royalty cannot be treated as consideration for service by the Government to O&G companies. Absent a quid pro quo in these transactions, there is no 'activity for consideration'.
- Royalty is not consideration for service; it is the Government's share in the profit and produce
- Government and the O&G companies are joint / co-venturers under the PSC: The share in revenues cannot be treated as payment of consideration by one member of the venture to the other for services.
- Payouts are in the nature of taxes and there can be no tax levied on a tax.

The levy of Service Tax on Royalty is not only significant, but also an addition to the costs of transactions, since it is not available as set-off (CENVAT Credit) for O&G companies. In this context, it is noteworthy that the PSC issued in terms of the New Exploration Licensing Policy ("NELP") provides assurances of fiscal stability to attract investment in the sector and provide certainty and stability on fiscal terms. Such a tax erodes the competitiveness of the O&G sector, particularly since the pricing in the industry is based on import price parity, and imported crude oil does not suffer incidence of such taxes. We suggest that a suitable clarification is issued confirming that no Service Tax is levied on Royalty and other payments under the PSC.

INFORMATION TECHNOLOGY (IT) AND IT ENABLED SERVICES (ITES)

3.11.1. Extend Deduction under Section 35(2AB) of the Income Tax Act to Computer Software

Currently, weighted deduction of 200% is available for expenditure incurred on scientific research on in-house research and development facility as approved by Department of Scientific & Industrial Research. The deduction is available to a company engaged in the business of bio-technology or in any business of manufacture or production of any article or thing. There is an ambiguity whether in-house Research & Development facility for computer software is covered within the ambit of section 35(2AB) and whether the software product should be eventually owned by the company.

It should be provided explicitly in the Act that the benefits of weighted deduction under section 35(2AB) of the Act are also available to companies engaged in the manufacture of 'computer software'. The definition of computer software for the purpose of this section should be the same as provided under Explanation 2 to section 10A of the Act.

3.11.2. Allow Weighted Deduction on Skill Development Expenditure

To promote skill development in the IT sector, weighted deduction on skill development expenditure incurred by IT companies should also be made eligible for deduction under section 35CCD of the Act.

3.11.3. Accelerated Depreciation on IT and Telecom Hardware Products

As per the announcement made by the Finance Bill, 2016, the highest rate of depreciation will now be restricted to 40% with effect from 1 April 2017 (i.e. from previous year 2017-18 and subsequent years). The accelerated depreciation on assets like computers (including computer software) is provided not as an incentive but considering their fast obsolescence due to rapidly changing technology. It is accordingly recommended that accelerated depreciation on computers and computer software be retained as even the current rate of 60% on computers (including computer software) is not sufficient keeping in mind the pace of technological obsolescence. Further, most IT products have approximately the same, if not shorter, life cycle as computers and computer software, however, accelerated depreciation is not allowed on them. It is recommended that the rate of depreciation in relation to computers, software and other IT products (i.e. all ITA goods) be increased.

3.11.4. Parity in the Treatment of Export Turnover and Total Turnover

The term 'total turnover' has not been defined in the Act. The tax authorities do not provide parity in the treatment of the term 'Export Turnover' ('ET') and 'Total Turnover' ('TT') for the purpose of computation of deduction under sections 10A/10AA/10B of the Act. Hence, certain items which are excluded while computing the ET are not excluded from the TT, thereby distorting the figure of ET/TT. If an undertaking does not have domestic turnover, then its entire profits should be exempt from tax under the provisions of Section 10A/10AA/10B, as the case maybe. However, because of the differential computation of ET and TT, the value of ET/TT is usually less than 1 and therefore, the deduction is not allowed for the entire amount of profits of such an undertaking.

It is recommended that definition of total turnover should be clearly provided in the Act and which should be in parity with the definition of export turnover (in relation to exclusion of certain items).

3.11.5. Clear Guidelines on Attribution of Profits to Permanent Establishment

Many a times, a Permanent Establishment ('PE') of foreign enterprises is alleged by the tax authorities on account of mere procurement of orders for sale of goods or provision of services or answering sales related queries, etc. These are routine services outsourced to Indian enterprises. Provision of these services is the backbone of IT/ITeS sector in India for which they get remunerated at Arm's Length Price ('ALP'). Foreign investors/companies are losing interest to invest in India since there is a tendency of the tax authorities to allege that the Indian entity is a PE of the foreign entity. They also fear attribution of profits of the foreign entity to such an alleged PE. This is in-spite of the fact that Indian entity is remunerated at ALP by the foreign company and such ALP is accepted during transfer pricing audit of the Indian entity.

It is recommended that the Act should categorically provide that no further profits can be attributed to PE, if PE is remunerated on arm's length basis.

INFRASTRUCTURE

3.12.1. Consolidated Group Tax Return

Currently, either due to bidding or financing requirements, parent infrastructure companies normally create multiple subsidiaries in the form of Special Purpose Vehicles ('SPVs') for each separate project. Separate SPVs are also incorporated to meet the guidelines of a concession agreement or to execute projects under the public-private partnership arrangements. As such, there could be a potential situation that Independent Power Producing Company may eventually be required to incorporate more than 50 SPVs to execute over 1 GW power projects of different sizes. Under the current tax regime, each SPV is regarded as an individual independent tax entity and, therefore, required to undertake separate and individual income-tax return filing. Significant efforts and cost are incurred for undertaking income-tax compliances.

The tax compliance and litigation costs directly impact the margins of the infrastructure company in this competitive market and negatively impact the ease of doing business in India. Considering above, it is recommended that the law should be appropriately amended to include provisions of group tax filing for infrastructure groups.

3.12.2. Rationalisation of Provisions pertaining to Infrastructure Investment Trusts ('INVITs')

Section 47(xvii) of the Act provides that the transfer of shares of an SPV (Special Purpose Vehicle) to a business trust, in exchange for units in such trust, would not be considered as transfer in the hands of the sponsor. The SPV is defined to be an Indian company and does not include any other forms of entity. Accordingly, the exemption has not been provided for transfer of interest in LLP. Where other assets (apart from shares) are exchanged, the same would trigger tax implications at the time of such exchange.

Considering LLP structure is being followed by large conglomerates increasingly, it is suggested that the above exemptions should be granted for transfer of interest in LLPs in exchange for units of business trust. It is further recommended that where other assets are transferred, the benefit of capital gains exemption may be extended to such assets as well.

Proviso to clause (42A) of section 2 of the Act provides period of holding for listed security (other than a unit) as 12 months to constitute 'long term' capital asset. Such period of holding should be applied even to units of business trust to determine the nature of capital asset. It is therefore suggested that necessary amendment be made in the Act to treat units of a business trust as long term if held for more than 12 months.

3.12.3. Amendment of Section 80-IA Regarding Upgrading Existing Infrastructure

Infrastructure development is a pre requisite for the growth and development of any country. Infrastructure development is available in two ways i.e. to build altogether new infrastructure or to convert the existing structure by upgrading it and also enhancing the existing capacity. Both activities entail huge investment and human efforts. However, there is ambiguity in the Act as to whether such modernisation or expansion projects qualify as "new" infrastructure facility in order to be eligible for income-tax holiday or weighted deduction under section 35AD of the Act.

It is recommended that a suitable amendment may be made in the Act to clarify that the up-gradation/extension of the existing infrastructure facility would also be eligible for the benefit under section 80-IA of the Act or under section 35AD of the Act (as per the amendment made by the Finance Act, 2016). Clarification on this issue would boost the investor sentiments and thereby lead to modernization of antiquated infrastructure of the country.

3.12.4. MAT on Infrastructure Companies

The tax holiday available to the infrastructure companies gets severely compromised since the companies are required to pay MAT on their book profits. A high MAT rate can have a significant impact on the project Internal Rate of Return. Resultantly, projects do not get complete benefit from the tax incentives provided by the Government. In order to provide tax exemption to infrastructure projects in letter and spirit and to attract more and more investment in infrastructure sector, it is advisable that MAT on infrastructure companies should be abolished.

3.12.5. Restoration of Deduction under Section 80CCF

Section 80CCF was applicable to an individual or Hindu Undivided Family for the investments made in long term infrastructure bonds. Maximum deduction which was allowed was up to Rs. 20,000. This deduction under section 80CCF was over and above the existing aggregate limit of deduction allowable under section 80C, 80CC and 80CCD of the Act. However, the said deduction was discontinued w.e.f. Assessment Year 2013-14.

It is recommended that deduction under section 80CCF of the Act should be continued and allowed for investments made by assesse.

3.12.6. Restoration of Section 10(23G)

Section 10 (23G) of the Act provided for exemption of interest and long-term capital gains, in the hands of infrastructure companies, derived from lending or investments made in approved eligible projects, development of special economic zones and housing projects. However, benefit was discontinued by the Government with effect from 1 April 2007.

Discontinuation of Section 10(23G) of the Act has affected entities who were engaged in infrastructure finance such as financial investors, infrastructure finance companies, banks etc. Post discontinuation, investors have started asking for higher returns since their income from infrastructure finance activities would now be taxable.

It is recommended to restore the benefit provided under section 10(23G) of the Act.

NON FERROUS METALS

I - COPPER

3.13.1. Exemption from the Levy of Import Duty on Copper Concentrate

Copper is a critical input for various industries, including infrastructure indicators. The critical raw material for this industry, i.e. copper concentrate, is available very scarcely in India, making it imperative for the country to import either refined copper or copper concentrate. Given the structural constraint of non-availability of copper concentrate, Indian producers set up custom copper smelters (similar to the business models of China, Japan and Korea) based on imported concentrate. Nearly 90% of the requirement for copper concentrates is met through imports.

Also, Indonesia has recently imposed a ban on the export of copper concentrate which was later replaced with massive export tax to discourage export from Indonesia. Similarly the other exporting country like Democratic Republic of Congo is also taking steps to ban export of copper concentrate.

Hence, it is recommended that copper concentrate be exempted from basic customs duty to ensure domestic availability of copper concentrates.

3.13.2. Increase in Customs Duty on Copper Products from 5% to 10%

Indian primary copper producers had set up global-scale capacities to maintain their cost competitiveness with state-of-the-art technology. However, this resulted in Indian refined copper capacity (close to a million tonnes) that is significantly higher than the domestic market size (nearly 0.6 million tonnes). Despite such excess capacity in India, imports of refined copper products are steadily going up from around 85,000 tonnes in 2012-13 to over 230,000 tonnes in 2015-16. This is eroding the market size available for the domestic players and the imports have a share of 35% of the total market. The Free Trade Agreements with Japan, Malaysia and other countries are causing a surge in the imports.

In view of the rising imports and considering the excess capacity in Indian refined copper industry, it is recommended that the Basic Customs Duty on copper products be increased from 5% to 10%

II - ALUMINIUM

3.13.3. Imposition of Export Duty on Alumina and Removal of Import Duty

Alumina is an intermediate product for production of aluminium metal from aluminium ore (bauxite) and primary raw material for production of aluminium metal. It contributes 40-45% of total cost of production of primary aluminium.

In India, aluminium smelters of 1.5 million tonnes capacity are ready but have not been commissioned due to non-availability of alumina. In case the indigenous requirement of alumina is fulfilled from domestic sources (instead of exporting the same to Middle East), India will be able to export aluminium which will fetch more value. This will also save outflow of foreign exchange and reduce load on infrastructure.

Also, Indian primary aluminium producers are finding it difficult to source alumina domestically and are forced to import. In FY16 India imported 9.21 lakh tonnes Alumina (31% increase over FY15- 7.02 lakh tonnes). The import of alumina is set to increase with the operationalization of upcoming expansion smelter capacities.

Hence, FICCI recommends for the imposition of export duty on alumina at 5% ensuring its domestic availability for aluminium production. Simultaneously, we also recommend for removal of import duty on alumina.

3.13.4. Reducing Import Duty on Aluminium Fluoride

India is net importer of Aluminium fluoride (AlF3). Aluminium industry is importing 100% of its requirement of AlF3. Contribution of Aluminium fluoride in cost of production of aluminium metal is around 1.5%. The demand for AlF3 will increase with the operationalization of expansion projects. Duty correction on AlF3 will not have any impact on any other industry. Hence, it is recommended to reduce import duty on Aluminium Fluoride from 7.5% to 2.5%.

3.13.5. Reducing Import Duty on Coal Tar Pitch to 2.5%

Coal Tar (CT) Pitch is a crucial raw material for aluminium to be used as binding material for manufacturing anodes for the electrolysis process with the aluminium industry using a substantial quantity of total production/imports of CT Pitch. Its contribution in the total cost of production of aluminium is around 3.5-4%. It is suggested to reduce import duty on CT Pitch from 5% to 2.5%.

3.13.6. Reducing Import Duty on Caustic Soda to 2.5%

Caustic soda is one of the major raw materials for the production of alumina, which is an intermediate product for production of aluminium metal from aluminium ore (bauxite). Caustic soda contributes around 13% in cost of production of alumina. One of the largest bulk consumers for the commodity, the aluminium industry contributes around 14% of total Indian demand for caustic soda. Aluminium industry imports almost 100% of its requirement of caustic soda contributing around 75% to the total imports of caustic soda. It is suggested to reduce import duty on Caustic Soda from 7.5% to 2.5%.

3.13.7. Increase in Basic Customs Duty on Aluminium Products

Indian aluminium industry has seen a huge surge in imports in recent years from 88 thousand tonnes in FY11 to 1.6 million tonnes in FY16 (CAGR of 11%) – primarily from China and Middle East, where aluminium industry is supported by Government in form of concessions/ subsidies with cheaper power tariff, low cost gas allocations, tax benefits, and VAT rebates on exports bringing down the production costs. In FY16 China and Middle Eastern countries accounted for 44% of the total aluminium imports in India.

The basic customs duty on aluminium products was increased by 2.5% in the Union Budget 2016-17 to check the imports. Despite 2.5% duty increase, aluminium imports have increased by 12% in Q1 FY17 over Q1 FY16. The aluminium imports Q1 FY 17 (436 thousand tonnes) were the second highest quarterly import in the last 4 years.

The surge in cheaper aluminium imports have threatened the market share of domestic primary aluminium producers in India which has gone down from 60% in FY11 to 49% in FY16 leading to low capacity utilization of primary producers at just less than 60%.

With such adversities it is recommended that the import duty on primary Aluminium (HS 7601) and downstream Aluminium Products (HS 7603-7616) should be increased from 7.5/10% to 15%.

3.13.8. Customs Duty on Aluminium Scrap to be at Par with the Duty on the Metal Products

For all base metals other than aluminium, import duty on scrap in India is the same as the duty on the metal. It is only in case of aluminium that the duty on scrap is 2.5%, while duty on aluminium products is at 7.5%. In most of the aluminium downstream products, scrap and primary aluminium can be used almost interchangeably. The differential duty structure seems to be, therefore, leading to a substitution of primary aluminium by scrap – reflected in a sharp rise in imports of scrap (CH 7602). Scrap imports are causing an immense harm to the Indian aluminium industry due to market diversion.

It is recommended that the basic customs duty on Aluminium Scrap (CH 7602) be raised and brought on par with the duty on aluminium products.

3.13.9. Inclusion of Aluminium Ingots under Interest Subvention Scheme

In order to encourage exports, Government has widened the Interest Subvention Scheme by including 134 engineering products vide a circular dated January 14, 2013 issued by RBI. While this list includes aluminium wire rods and aluminium sheets, it does not include the primary product, i.e. Aluminium Ingots (HS 7601). Export of Primary (unwrought) Aluminium (7601) during 2013-14, 2014-15 and 2015-16 has been to the order of 408 KT, 660 KT and 874 KT respectively. These exports may get some leverage if ingots are included under the above scheme. It is, therefore, recommended that Aluminium Ingots (HS 7601) be included under the Interest Subvention Scheme.

3.13.10. Increasing of Export Duty on Bauxite

India's alumina refinery capacity is 6.28 million tonnes per annum. The requirement for bauxite is around 18.8 million tonnes per annum. Since no new major bauxite mines could be started in the last 20 years, Alumina refineries in India are finding it difficult to source indigenous bauxite and are forced to import. On the other hand merchant miners are exporting huge quantities of bauxite.

Even though the export duty on Bauxite was increased from 10% to 20% in Union Budget 2014-15, it has failed to stem outflow of bauxite. Total bauxite exports increased by 93% in FY15 and by 30% in FY16.

Reduction of export duty on bauxite from 20% to 15% in the Union Budget 2016-17 made the situation more difficult for Indian primary aluminium industry. Cost of bauxite is in the range of $40-50/t, so 15% duty is not sufficient to curtail exports.

Presently, the Indian aluminium industry is facing an acute shortage of bauxite and is forced to import bauxite from African Countries. It is evident that on one hand the bauxite is being exported from Gujarat and Maharashtra and on other hand, huge foreign exchange is being drained out to import bauxite from other countries.

To ensure domestic value addition within India, export of bauxite must be discouraged. It is therefore suggested to increase export duty on bauxite from 15% to 20% as was announced in the Budget 2014-15.

III - Miscellaneous

3.13.11. Import duty on Manganese Ore, Chrome Ore

Customs duty on Manganese ore, Chrome ore, Molybdenum ore, Vanadium oxides, Hydroxides and other salts of Oxometallic Acids (Vanadium Oxides Concentrates and Ammonium Meta Vanadate) may be reduced to Nil from the existing 2.5%

3.13.12. Inverted Duty Structure due to Free Trade Agreements (FTA)

Due to FTA with ASEAN, finished and semi-finished products of copper and other alloys are imported into India at nil rates whereas raw material is chargeable at 5%. Copper Cathodes (HS 74031100), Copper Rods (HS 74031200), Copper

Scrap (HS 74040012), Brass Scrap (HS 74040022), Zinc Ingots (HS 79011100, 79011200), Copper Blisters (HS 74020010), Copper Anode (HS 74020090) are subjected to an import duty of 5%.

Import duty on all above mentioned raw materials should be removed to create a level playing field for the domestic industry over their overseas counterparts.

PAPER AND PAPER BOARD

3.14.1. Retention of Peak Rate of Customs Duty on Paper and Paperboard

It is an acknowledged fact that as a result of the global economic scenario, the Indian Pulp and Paper Industry has become very vulnerable and endeavour of major global players in the international market is to push large quantities of paper and paperboard into the Indian market. Further, the economic slowdown in developed economies and export dependent economies like ASEAN countries has led to severe excess capacity of paper and paperboard in these countries. Taking advantage of the low import duty rates, these countries find India as an attractive outlet for diverting their excess inventory. The scenario has become grimmer with the basic customs duties on most of the paper and paperboard coming down to nil rate from 01.01.2014 under the India-ASEAN FTA.

Imports of paper and paperboard, excluding newsprint, into India have been steadily increasing. In the last five years, imports have risen at a CAGR of 15.5% in value terms (from INR 3,411 crores in 2010-11 to INR 7,014 crores in 2015-16), and 15.8% in volume terms (from 0.54 million tonnes in 2010-11 to 1.11 million tonnes in 2015-16). Imports of paper and paperboard, excluding newsprint, into India from ASEAN in the last five years have risen at a CAGR of 37.5% in value terms and 38.5% in volume terms.

Increased import of paper and paperboard is severely impacting the economic viability of many paper mills in India apart from revenue loss to the Government. In light of the above, the case for retention of the current duty structure, with the basic customs duty at 10%, is fully justifiable and much needed under the present circumstances in order to save the domestic Pulp & Paper Industry from injury arising out of unbridled imports.

Customs duty on import of paper and paperboard from ASEAN countries should be brought back to the MFN rate with immediate effect, with a view to ensure that the capital already invested and proposed to be invested in further capacity creation by Pulp & Paper Industry in India is safeguarded, incentivized and grown further.

3.14.2. Increase in Applicable Rate of Customs Duty on Newsprint

Newsprint is subject to 'nil' rate of duty on imports. There is also no additional duty and special additional duty on import of newsprint. As a result, newsprint is being dumped into the country by the overseas suppliers which has very adversely impacted the domestic newsprint manufacturers. The registered newsprint manufacturers are not able to sell their product competitively and the large quantum of imports has resulted in large foreign exchange outgo and revenue loss to the Government.

In light of the above, the Government should increase the applicable rate of customs duty on newsprint to the WTO bound rates to save the Indian Newsprint Industry.

3.14.3. Reduction of Excise Duty on Poly-Coated Paper and Paperboards

Paper and Paperboard, coated, impregnated or covered with plastics, excluding adhesives (HS Code 48114900) are coated with layer of plastics on either one or both sides. This coating to the paper / paperboard imparts barrier properties and makes it suitable for packaging / containers for foods and beverages. This type of board is bio-degradable and a

good substitute for plastics which do not match the hygiene and environmental standards of this type of boards / paper. Globally, the trend is to actively discourage the use of plastic and support its replacement with paper / paperboard material. One of the major consumers of this type of paper / paperboard are the MSME units engaged in the manufacture of paper cups for supply to institutional consumers including railways and meeting the growing demand from FMCG and household sectors who prefer such products.

It is requested that excise duty on Poly coated Paper and Paperboard (Paper and Paperboard, Coated, Impregnated or Covered with Plastics, excluding Adhesives) be reduced from 12.5% to 6% - in line with most other paper / paperboards classifiable under Chapter 48.

3.14.4. Customs Duty on Import of Pulp

In May 2012 the Government reduced the import duty on pulp from 5% to "Nil". More than 1.25 million MT of pulp, valued at approximately USD 820 million is imported in to the country every year. The customs duty for these imports is estimated to be about Rs. 245 crore p.a.

The break-up of the pulp imports is as under:

Type of Pulp	Quantity ('000 MT)	Value (Rs. Crore)
Hard Wood Chemical Pulp	900	3,420
Soft Wood Chemical Pulp	200	900
Bleached Chemi Thermo Mechanical Pulp (BCTM Pulp)	160	580
Total	**1,260**	**4,580**

In view of the fact that Soft Wood cannot be grown in the country, requirement of Soft Wood Pulp will have to be met through the import route only. However, in so far as Hard Wood Pulp is concerned, it would be pertinent to note that the domestic industry is working closely with the farming community for creating sustainable supply of wood – a key raw material for hard wood pulp – through re-development of waste-lands.

In so far as Bleached Chemi Thermo Mechanical Pulp (BCTMP) is concerned, the technology for manufacturing BCTMP has not been available in India. In line with the vision "Make in India", for the first time, the industry is setting up a state of art BCTMP manufacturing facility in India. The project involves huge capital investments and will continuously save forex outflows that would otherwise be spent for import of BCTM pulp.

In an era of increasing global competition it is necessary for governments and industry to work in partnership to ensure creation of economic wealth for the nation. Accordingly, for creation of sustainable sources of fibre required by the pulp and paper industry it is recommended that:

(i) policy measures be put in place to facilitate private sector participation in plantation development programmes, and

(ii) 10% customs duty on pulp be imposed only for Hard Wood Chemical Pulp and Bleached Chemi Thermo Mechanical Pulp (BCTMP)

3.14.5. Clean Energy Cess

Levy of a Clean Energy Cess on purchase of coal was introduced in 2010 and the same was increased from Rs. 50 per MT in 2010 to Rs. 200 per MT in February 2015. Thereafter, in the Union Budget of 2016 the Cess has been increased further to Rs. 400 per MT. No doubt, the Cess was introduced on the principle of "polluter pays". Whilst this principle

may be justifiable for industries causing environmental pollution, it must be kept in mind that within the industry there are players who have invested considerable sums of money on state of the art technology like elemental chlorine free paper manufacture, ozone bleaching processes, waste water management, solid waste recycling, usage of energy from renewable sources etc. to ensure environment friendly manufacture.

In view of the above, levy of a clean energy cess on coal should be exempted for manufacturers who adopt clean technology and make best use of the green energy at considerable investment. Alternately, these manufacturers should be allowed to avail credit of the Cess paid as a CENVAT Credit.

STEEL AND OTHER FERROUS PRODUCTS

3.15.1. Increase in Import Duty on Stainless Steel Products to 15%

The current import duty on Stainless Steel Products in India is at 7.5%, which is much lower in comparison to duty prevailing in other Stainless Steel producing countries. This has led to increased imports from 324,460 MT in 2013-14 to 532,033 MT in 2015-16. Imports from China have more than doubled from 111,765MT in 2013-14 to 276,456 MT in 2015-16. China now accounts for more than 50% of the import basket. This is the single largest threat for the industry today.

Also, in view of the comparative advantage enjoyed by China in various cost components, it is imperative to create a level playing field between domestic stainless steel manufacturers and the Chinese manufacturers.

Therefore the Basic Customs Duty on stainless steel flat products need to be increased from the existing 7.5% to 15%.

Also, in order to safeguard the huge investment made towards the development of the Indian stainless steel industry, the peak duty rates for stainless steel may be raised to 25% from the existing 15%.

3.15.2. Customs Duty on Seconds and Defective Goods falling under Chapter 72

Prime quality of major finished steel products is liable to customs duty @ 12.5%. However, seconds and defective goods falling under Chapter 72 of the Customs Tariff are liable to customs duty @ 15%. In view of the narrow margin of difference between the rates of import duties of prime quality and seconds / defective goods, there has been a surge of imports of ‘seconds’ and ‘defective’ steel products in the country. This is putting further pressure on the industry already grappling with the challenge of subdued demand and rising cost of production; alongside raising the quality concerns for long-term infrastructure and construction projects using steel. In order to suppress the imports of defective steel into the country, the rate of seconds / defective goods needs to be increased. It is suggested that customs duty on seconds and defective goods falling under Chapter 72 be raised to 40%.

3.15.3. Exemption of Import Duty on Stainless Steel Scrap

The domestic stainless steel industry uses Electric Arc Furnace (EAF) route for manufacture of stainless steel and is, therefore, constrained to use of Stainless Steel (SS) Scrap instead of Iron Ore. The bulk of the scrap requirements of the domestic stainless steel producers are met through imports; procured mainly from countries like Europe, Korea, South East Asia, Central Asia etc.

Despite the dependence of domestic industry on imported scrap, the Ministry of Finance has announced increase in Basic Customs Duty on Stainless Steel Scrap (HS Code720421) and Steel Scrap (HS Code 720449) from NIL to 2.5%. However, China maintains its scrap duty at zero.

It is suggested that the duty on Stainless Steel scrap be restored to the original rate of “NIL”.

3.15.4. Exemption of Import Duty on Ferrous Scrap

Government has increased import duty on Ferrous Scrap from NIL to 2.5% on May 8, 2013. Since India doesn't generate enough ferrous scrap, the demand for the same has to be met by imported scrap. Levying import duty on raw material is not justified as it increases the cost of steel production in the country. Hence, the import duty should be brought back to NIL.

3.15.5. Reduction in Import Duty of Iron Ore to NIL from 2.5%

There is an anomaly in having the import duty on iron ore as we simultaneously also have an export duty of 30% on high-grade iron ore and pellets. With the duties on imported steel coming to zero under FTAs, there is also a case of inverted duty structure with 2.5% import duty on the raw material iron ore. This is encouraging import of finished steel in comparison to the raw material which is against the basic principle of "Make in India".

It is therefore requested that the import duty on iron ore should be brought down to NIL, from the currently levied 2.5%.

3.15.6. Reduction in Customs Duty on Coking Coal to NIL

Coking coal is used largely by the steel industry. Negligible quantity of coking coal is available domestically, and thus the need is met mainly from imports. The zero duty on coking coal was in place since 1978. However, its increase to 2.5% in the Union Budget 2014-15 has increased the cost of steel making substantially and has rendered the domestic steel being uncompetitive vis-à-vis imports. It is therefore recommended that the duty on coking coal be exempted as was the case earlier.

3.15.7. Reduction of Import Duty on Steel Grade Limestone and Dolomite to NIL

For Indian steel industry, the cement grade limestone reserves are adequate but the reserves of SMS, BF and Chemical grade limestone are not adequate and are also available in selective areas. Increase in steel production in the country, has led to rising demand for SMS and BF grade limestone. Therefore the limestone imports have been increasing consistently. It is imperative that Customs Duty on steel grade limestone (sub heading 2521 00 10) and dolomite (sub heading 2518 10 00) be reduced from 2.5% to NIL.

3.15.8. Reduction of Basic Customs Duty on Metallurgical Coke to NIL

Basic Customs Duty on metallurgical coke has been placed at 5%. Coking Coal, Steam Coal and Met Coke are key inputs in steel making, accounting for substantial portion of cost of production for steel. Historically, coal used for metallurgical purposes have enjoyed exemption as steel is critical in fueling India's growth. Subsequently, due to scarce availability of coking coal and cost impact the technology has been developed to use other coal (non-coking coal including what could be termed as steam coal) for metallurgical purposes through technologies such as COREX. During the period 2012-2013 such coal was exempt (Sl. No. 123 of Notification No. 12/12-Cus dated 17.03.2012) but this exemption was subsequently withdrawn. Therefore, we suggest a reduction of Basic Customs Duty on metallurgical coke to NIL.

3.15.9. Reduction of Customs Duty in Natural Gas to NIL

India has a gas based steel manufacturing capacity of 10-12 MTPA accounting for almost 9% of the total steel manufacturing capacity in the country. The gas based units in western coast of the country were the earliest gas users and have contributed in a big way in nurturing the gas and steel industries during their nascent years. These plants were set-up pursuant to 5.46 MMSCMD of domestic gas allocation by Gas Linkage Committee (GLC), Government of India between 1991 & 2002 and 4.20 MMSCMD by EGOM in 2009 on priority to compensate for APM gas supply curtailed. However, the units today are facing unprecedented challenges for their sustainability due to non-availability of affordable natural gas.

These units also represent more than 45% of sponge iron production in the country and are critically dependent on natural gas as feedstock. Although these units have an allocation of more than 7 MMSCMD domestic gas from APM and RIL KG D6 but are currently receiving less than 0.60 MMSCMD gas. Due to the non-operations of these units, it has to face adverse effects such as stranded investment and unemployment. It is essential that customs duty on LNG is made NIL without "Any User Condition" so that user industries including Gas Based Steel Plants are able to import LNG for usage in making of steel.

3.15.10. Reduction in Customs Duty on Ferro Nickel, Pure Nickel and Ferro Moly to NIL

Stainless steel is made of combination of iron, chromium, silicon, nickel, carbon, nitrogen, and manganese. Properties of the final alloy are tailored by varying the amounts of these elements. It is a highly raw material intensive industry with over 70% of the cost being accounted for by raw material and therefore adequate raw materials availability is critical for this industry.

The key ingredients for production of stainless steel include Ferro Nickel, Pure Nickel, Ferro Moly etc. These are not available in India and need to be necessarily imported for production of stainless steel.

Therefore, the Basic Customs Duty on all key raw materials like Ferro Nickel, Pure Nickel, Ferro Niobium, Ferro Vanadium, Ferro Titanium and Ferro Moly be reduced to zero to ensure that domestic industry remains competitive globally. It would also help the Indian stainless steel manufacturers to pursue a more aggressive export strategy since they would be cost competitive in the international markets.

3.15.11. Import Duty on Electrodes, Refractory Material to be reduced to NIL

Currently there is import duty of 7.5% on electrodes (sizes 30" and 16") and 5% for refractory materials. As there is no sufficient domestic capacity for manufacture of these items and need to be imported, the cost of domestic producers is increased; therefore the import duty on electrodes and refractory material may be reduced to Nil.

3.15.12. Removal of Clean Energy Cess

The hike in clean energy Cess from Rs 200 per Tonne to Rs 400 per tonne in Union Budget 2016-17, should be rolled back to the old level. Steel Plants having ISO 14001 accreditation or Clean Development Mechanism (CDM) under the Kyoto Protocol shall be exempted from the payment of Clean Energy Cess.

3.15.13. Reduction of Excise Duty on Pre-fabricated Structures to 8%

Pre-engineered building / pre-fabricated structural have emerged in India for last few years owing to fast track steel based construction and to incorporate the latest innovative designs requiring special profiles developed by structural engineers and architects in the field of construction.

It has been an anomaly that while the site based pre-fabrication of structurals are permitted to be used in the building / structure without payment of Excise Duty as these are not taken out of the site, the pre-fabrication activities conducted on structurals at outside premises of the pre-fabricated manufacturers are excisable @ 12.5%. This has led to mass fabrication of structurals at the site which do not follow the quality norms as required in structural fabrication and generally done by fabricators having little knowledge of good quality fabrication. On the other hand, the steel structurals fabricated at the premises of fabricators follow state-of-the-art technology and standard operating practices of good fabrication, are priced much higher (after loading Excise Duty of 12.5%) and hence lack orders.

It is, therefore, recommended that the Excise Duty on fabricated steel structure undertaken by PEB/Pre-fabricators at their own premises be reduced from the current 12% to 8%. This would reduce the price gap between steel fabrication at sites and at fabricators premises and would prompt the consumers to go in for quality fabrication.

TOURISM

3.16.1. Service Tax on Room Rent and on Sale of Food and Beverages

In Finance Act 2011 the scope of Service Tax was expanded to levy Service Tax on renting of Rooms and Food and Beverages sales by Air Conditioned Restaurants having liquor license (subsequently the coverage was extended to all restaurants) despite the fact that in hotels Luxury Tax is charged on renting of Rooms and VAT is charged by all hotels and restaurants on Sale of Food and Beverages.

Whilst the current abatement in respect of service tax has been provided @ 40% for Rooms and @ 60% for Food & Beverage, on the balance portion there is an element of double taxation – Service Tax and Luxury Tax in the case of Rooms and Service Tax and VAT in the case of Food & Beverages.

The total tax outflow for the Guest works out to more than 20% on an average. Consequently, this tax levy is a significant deterrent to the Hospitality Industry which is already impacted adversely by the general slowdown of the global economy.

The levy of Service Tax on renting of Rooms and sale of Food and Beverages be discontinued to provide some relief to the industry.

DIRECT TAXES

4.1. Tax Rates – Companies/Firms/Limited Liability Partnership

Issues

- The tax rate on domestic companies is currently being levied at 30%, which is quiet high in comparison with the global standards. The Hon'ble Finance Minister while presenting Budget 2015-2016 stated that the rate of corporate tax will be reduced from 30 per cent to 25 per cent over the next four years along with corresponding phasing out of exemptions and deductions available under the Income Tax Act, 1961 ('the Act'). The Finance Act, 2016 has phased out many exemptions and deductions available under the Act, however, the rate of tax has been reduced to 29%, that too, for a domestic company provided its total turnover or gross receipts in the previous year 2014-2015 does not exceed Rs. 5 crore.

  It is also observed that most of the deductions and exemptions phased out by the Finance Act, 2016 are applicable to both companies as well as firms/Limited Liability Partnerships ('LLPs'). However, the benefit of reduction of tax rate is not passed on or being considered to be passed on to such other assessees. The rate of tax for firms and limited liability partnership is considerably high and needs to be reduced to 25% in sync with the reduction in corporate tax rate and phasing out of deductions and exemptions. This would facilitate ease of doing business in any form and not particularly restrict the benefit to corporates and also provide a level playing field amongst these forms of business.
- The Finance Act, 2015 increased the rate of surcharge by 2 per cent if the income exceeds a specified threshold (10 crores in case of a domestic company and 1 crore in case of a Firm). The increased rate of surcharge on tax makes cost of doing business in India significantly high. The increased tax cost adversely impacts the investors' sentiments and economic growth.
- In addition to high tax rate, enhanced DDT and lowered depreciation rates, impose a further strain on companies, leading to increased pay-out of taxes thus leaving inadequate funds for generation of internal resources for ploughing back for expansion, modernization, technology up-gradation, etc.

Recommendations

- It is suggested that reduction in the corporate tax rate should not be restricted to certain domestic companies. Instead of being conditional, it should be extended to all the corporate taxpayers.
- The income tax rates for unincorporated bodies i.e. Firm, Limited Liability Partnership (LLPs), etc., should also be reduced to 25% from the current 30%.
- It is recommended that the Corporate Tax rate of 25% should be after inclusion of surcharge and education cess.
- Consistent with the reduction of rates of tax, the rate of Dividend Distribution Tax may also be reduced suitably so as to be competitive in terms of the comprehensive tax burden.
- It would be appropriate to remove the levy of surcharge and education cess on corporate and non-corporate taxpayers.

4.2. Tax Rates - Individual Taxpayers

Currently, the peak tax rate of 30% is made applicable over an income of Rs. 10 lakhs for individual taxpayers. However, the income level on which peak rate is applied in other countries is significantly higher. Hence, there is a need for further raising the income level on which the peak tax rate would trigger, to make the same compatible with the international standards.

FICCI recommends the following revised tax slabs for individual taxpayers. FICCI would, therefore, like to urge that the aforesaid recommendation be implemented during FY 2017-2018.

Slab (Rs. lakhs)	Tax rate
0-3	Nil
3-10	10%
10-20	20%
Beyond 20	**30%**

The Finance Act, 2016 has levied surcharge @ 15% on individuals having total income exceeding Rs. 1 crore. The surcharge @ 10% on individuals having taxable income above Rs. 1 crore was introduced in the Budget 2013-2014 though only for a year. The surcharge on individuals has been increased over the years from 10% to 15%. It is observed that the increased surcharge on certain category of individuals distorts equity and tends to discourage entrepreneurship and incentivizes people to relocate to other locations. It is suggested that the Union Budget 2017-2018 should withdraw the levy of surcharge on individuals having income above Rs. 1 crore.

4.3. Minimum Alternate Tax and Alternate Minimum Tax - Section 115JB/115JC

Issues

- Current rate of MAT of 18.5% is quite high and has impacted significantly cash flow of companies who otherwise have low taxable income or have incurred tax losses. Further, this has also diluted significantly the tax incentives offered under Chapter VI-A of the Act to eligible businesses and industrial undertakings as the difference between the corporate tax rate of 30% and MAT of 18.5 % is not very high.
- Further, an Alternate Minimum Tax (AMT) was also introduced on LLPs, individuals, HUF, AOP etc. which is to be computed on adjusted total income. Adjusted total income is total income as increased by deduction claimed under Chapter VI-A and Section 10AA of the Act and under section 35AD of the Act (net of depreciation).

  Pursuant to above, LLP's who have invested large sums in eligible businesses/industrial units in the backward areas are also getting penalized as the benefit of such incentive gets reduced.
- Presently, the amount of loss brought forward or unabsorbed depreciation whichever is less as per books of account is allowed as a deduction while computing book profits under section 115JB of Act. A company having huge book losses and meagre unabsorbed depreciation or vice versa would be adversely affected and would end up paying MAT despite having accumulated losses. This causes undue hardship to revive companies and hampers the revival process substantially.

  Further, the Act does not provide the methodology to compute the amount of loss brought forward or unabsorbed depreciation as per books of accounts for the purpose of claiming deduction while computing book profits under section 115JB of the Act. The issue has created unwarranted litigation and needs to be resolved.
- The MAT/AMT credit is allowed to be carried forward for 10 years for set-off but this period is generally not always sufficient. Many companies, particularly investment companies whose core business is investments are not able to utilize MAT credit efficiently and within due time-limits provided.

- The MAT Credit allowable under the Act is difference of income tax payable under normal provision of the Act and MAT which would have been payable. Due to the said restriction, the taxpayers are not able to utilize the credit efficiently in time and therefore, in most of the case the credit is either not available or is lapsed. Further, there is an ambiguity as to whether surcharge and cess paid on MAT is allowed as a MAT credit.
- Income arising from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund is exempt under Section 10(38) of the Act. The objective of giving such exemption was that Indian residents should invest in the capital market for long term, however, by including such income in the book profit the benefit is taken back from the Companies. Taking back such benefit from the Companies is not equitable.
- As per section 115BBD of the Act, dividend paid by a foreign company to an Indian company, in which the Indian company holds 26% or more of the equity share capital in the foreign company, such dividends are subject to tax @ 15%. However, MAT is levied at a rate higher than 15% on such dividend income, which defeats the purpose for which section 115BBD was introduced. The consequence is that an Indian companies will end up paying an effective tax of 21.34% on foreign dividend due to applicability of MAT provisions as against the effective rate of 17.30% stipulated under the provisions of section 115BBD of the Act. Further, since the Indian companies have made outbound investments through investment companies which generally do not have any other source of income, the companies would not be able to utilize the MAT credit.
- The Finance Act, 2011 broadened the scope of MAT by bringing SEZ developers and units under the ambit of MAT thereby significantly diluting benefits offered under the popular SEZ Scheme. In this regard, the Finance Minister in his Budget speech for 2014-15, stated that manufacturing is of paramount importance for the growth of the economy. He further stated that the Government is committed to revive the SEZs and make them effective instruments of industrial production, economic growth, export promotion and employment generation.
- Exemption from AMT is provided to certain specified persons if the adjusted total income of such person does not exceed Rs. 20 lakhs. The limit of Rs. 20 lakhs is inadequate considering especially the huge amount of investments made by the businesses in relation to export of goods and services.
- MAT provisions have been amended vide Finance Act 2016 to state that MAT will not be applicable to foreign companies in following circumstances:-
  - Where the foreign company is resident of a country with which India has entered into a tax treaty and such foreign company does not create a Permanent Establishment (‘PE’) in India as per such tax treaty.
  - Where the foreign company is resident of a country with which India has not entered into a tax treaty and such foreign company is not obliged to seek registration under the relevant provision of Companies Act, 2013.

  For MAT purposes, book profits are required to be computed under the Corporate Law. As per Corporate Law, an entity having a place of business in India (including in an electronic form) is required to maintain books of account. In light of the above, applicability of MAT to entities following gross or net basis of taxation would depend on its presence or place of business in India.

  Based on presumptive tax regime (e.g.; taxability under section 44BB of the Act), companies opting for deemed taxation under the said section are not required to maintain books of accounts for the purposes of the Act. However, as stated above, for MAT purposes, book profits are required to be computed under the Corporate Law.

There is an ambiguity whether companies taxed under presumptive tax regime and are provided with specific exemption from maintaining book of accounts under the Act, would be eligible to MAT provisions.

- The issues emanating from the report dated July 23, 2016 of the Committee suggesting framework for computation of book profit for the purposes of levy of MAT under section 115JB of the Act for Ind AS compliant companies in the year of adoption and thereafter are placed below for consideration of the Government:-
  - The Committee has recommended that the adjustment due to lease equalisation to the retained earnings be included in the book profits over a period of three years starting from the year of first time adoption of Ind AS. It is observed that lease equalisation levy with respect to leased assets gets computed over the period of lease. The lease duration differs on case to case basis and can vary from 3 years to 30 years. Spreading the entire levy over a standard period of three years is arbitrary. It is recommended that retained earnings adjustment should be included in the book profit over the lease period in the same manner as it would have been included under AS-19 as per option (b) instead of option (c) recommended by the Committee.
  - In respect of fair value adjustments in respect of financial instruments, the Committee has recommended that the retained earnings adjustment should be included in the book profit over a period of three years starting from the year of first time adoption of Ind AS. It is observed that with respect to fair valuation of investment in subsidiaries – the recommendation that the adjustment to retained earnings in MAT computation is to be done in three years goes against the basic tenant of going concern concept. Investment in subsidiaries are done for strategic reasons, hence the probability of getting the same realised is minimal. The taxing of unrealised profits is against the well-established cannon of Taxation of 'Real Income Theory' and that too in three years is subjecting business to hardship. It is to be noted that in generally inflationary times, the fair value of investments is expected to be much higher than the original cost. It is recommended that fair value of investments in equity instruments through profit and loss account should be in line with the original recommendation made by the Committee i.e. with respect to adjustment in other comprehensive income (OCI) i.e. at the time of realisation only.
  - As per the existing provisions of clause (i) to Explanation 1 to section 115JB of the Act, "book profit" means the net profit as shown in the profit and loss account as increased by the amount or amounts set aside as provision for diminution in the value of any asset. Further, as per the revised recommendation of the Committee, any gain on account of fair valuation of investments will be added back in computation of book profit over a period of three years. However, clarification is required whether loss on account of fair valuation of investments, being adjusted in retained earnings, will be allowed as a deduction or not as the same will be caught under the existing clause of Sec 115JB, cited above. It is being observed that book profit on account of impairment in valuation of investments gets disallowed whereas the gain is being considered for the purpose of computation of Book profit. This anomaly should be explicitly clarified by providing that in case of decline in fair valuation deduction while computing book profits for the purpose of MAT should be allowed.

Recommendations

- With the phasing out of exemptions and deductions available under the Act, the burden of MAT should also be gradually reduced from the current levels of 18.5 per cent to a rate which will be commensurate with the phasing out of tax exemptions and incentives.

- Companies should be allowed to set-off entire past book losses including unabsorbed depreciation before they are subjected to MAT. Further, the methodology for computing loss brought forward and unabsorbed depreciation as per books of account be specifically provided in section 115JB of the Act.
- The MAT/AMT credit should be allowed to be carried forward and set-off without any time limit.
- Currently, sale of listed securities is free from levy of Capital Gains Tax. This has resulted in buoyancy of Capital Markets, promoted substantial FII inflows and ensured transparency. However, there is one lacuna here. If the seller of the listed shares is a company, there is no taxability of the gains but the book profits are subject to the levy of Minimum Alternate Tax (MAT). The levy of MAT at 20 per cent + defeats the very exemption from levy of capital gains tax. It is therefore suggested that profits which are exempt from levy of capital gains tax be also not taken as part of book profits for the purposes of MAT.
- It is recommended that dividend received from foreign company should be exempt from MAT just like domestic dividend is exempt from MAT.
- MAT on SEZ developers and units should be abolished.
- The threshold limit from exemption of AMT should be increased from Rs. 20 lakhs to Rs. 50 lakhs.
- The amount of weighted deduction under Section 35(2AB) of the Act should be deducted while computing MAT. The benefit of investment linked deductions is getting diluted as MAT/AMT at 18.5% applies on book profits. Therefore, these deductions should also be allowed while computing the book profit/adjusted total income under the provisions of Section 115JB/Section 115JC of the Act respectively.
- In computing the adjusted total income for AMT, investment linked deductions on capital expenditure for specified business (net of depreciation) should not be added back under Section 115JC of the Act.
- To attract more industrial and infrastructural investments, MAT/AMT on eligible businesses/industrial undertaking should be abolished.
- Set off of MAT credit should be allowed in full (including applicable surcharge and cess paid on MAT).
- It should be clarified that MAT provisions would not apply to foreign companies which are taxed as per the provisions of presumptive tax regime under the Act.

4.4. Dividend Distribution Tax - Section 115-O

Issues

- As per the provisions of Section 115-O of the Act, the domestic holding company will not have to pay DDT on dividends paid to its shareholders to the extent it received dividends from its subsidiary company on which DDT has been paid by the subsidiary. However, the provision as it stands on today, gives relief in respect of dividend received from only those companies in which the recipient companies are holding more than half of the nominal value of equity capital.
- The proviso to Section 115-O(1A) of the Act provides that the same amount of dividend shall not be taken into account for reduction more than once. The levy of Dividend Distribution Tax (DDT) at multiple levels has been a subject matter of grievance by corporates. A part of this issue has been resolved by providing in the Act that if a holding company receives dividend from its subsidiary, a further distribution of dividend by the parent will not attract levy of DDT. However, proviso to section 115-O(1A) of the Act raises ambiguity regarding the cascading effect of DDT in a multi-tier structure which is against the intent of the Government. Further, as it happens, promoter holdings in operating companies are not necessarily in a single parent. Also, irrespective of whether

there exists a parent-subsidiary relationship, a tax on dividends which have already suffered levy of DDT amounts to multiple taxation and needs to be avoided.

- Further, the Finance Act, 2011 has also burdened the SEZ developers by including them in the scope of DDT.
- It is still also unclear whether the rate of surcharge (and even cess) has to be considered while grossing up the amount of distributable profits. The Government should specifically clarify this aspect to avoid litigation.
- The earlier DDT rate of 10% was lower in line with the rate of TDS on dividends in most Indian and international tax treaties. The increased basic DDT rate of 15% (effective rate of about 20%) reduces the dividend distribution ability of domestic companies and the uncertainty with respect to its credit in overseas jurisdictions impacts the non-resident shareholders adversely.
- Currently, DDT is also levied on undertakings engaged in infrastructure development which are eligible for tax benefit under Section 80-IA of the Act. This is detrimental to the growth of the Indian Economy.

Recommendations

- All dividends on which DDT has been paid, be allowed to be reduced from dividends irrespective of the percentage of equity holding keeping in mind that investment companies which do not necessarily own/have subsidiaries as they invest in various companies in the open market, be also made eligible for such benefit.
- It is suggested that dividends which have suffered DDT be treated as pass through and be not subjected to levy of DDT. It is recommended that an appropriate explanation be inserted clarifying that the benefit of DDT paid by a subsidiary company is available at each company level in a multi-tier corporate structure so as to avoid the cascading impact of DDT. This will go a long way in boosting investor's confidence and improve the ease of doing business in India.
- To attract more investment in the SEZs, DDT on SEZ developers and units should be abolished.
- The tax rate of DDT is recommended to be reduced to 10% from the current effective rate of about 20% (after including the education cess, surcharge and grossing-up of the dividend).
- To incentivise the investment in infrastructure sector, it is recommended that DDT on industrial undertakings or enterprises engaged in infrastructure development, eligible for deduction under Section 80-IA of the Act, should be abolished.

4.5. Tax on certain Dividends received from Domestic Companies - Section 115BBDA

Issue

The insertion of section 115BBDA in the Act to tax dividends in the hands of the recipient which have already suffered corporate tax, dividend distribution tax; results in economic triple taxation.

Recommendation

It is recommended that new levy amounting to third level of taxation on profits may be done away with.

4.6. Abolition of Securities Transaction Tax and Commodities Transaction Tax

FICCI is against levy of any transaction taxes in principle. Securities transaction tax adds to the cost of the transaction and serves as a major deterrent for the retail investor. FICCI also observes that the imposition of a Commodities Transaction Tax (CTT) impacts the volume and liquidity of commodity exchanges, thereby hampering the growth of a nascent market. The commodity transactions in India are already heavily taxed, being subject to a plethora of taxes. Imposition of CTT impacts the volume of trading significantly and thus exporting our market to other global exchanges, as globally, the

cost of a hedging transaction in commodities is significantly lesser than what is paid in India. It is recommended that the imposition of the transaction tax in the form of securities transaction tax and commodities transaction tax be abolished.

4.7. Deemed Dividend - Section 2(22)(e)

Section 2(22) of the Act defines the term 'dividend' and sub-clause (e) thereof includes, within the meaning of this term, even an advance or loan, to a shareholder having at least a 10% voting-power in a company in which the public are not substantially interested, to the extent that the company possesses accumulated profits. Thus, a payment, which is clearly not a dividend as commercially understood, is, by a fiction of law, deemed to be one. Apart from payment to the shareholder himself, a loan or advance to any concern in which he is a partner or a member, with a beneficial interest of not less than 20% is also considered, to be deemed dividend, and is taxed accordingly. The object clearly is to prevent tax-avoidance by deeming an advance or loan (which would not be taxable) as dividends which is subject to income tax.

4.8. Taxability of Genuine Inter-corporate Loans and Advances as Deemed Dividend

Issues

The provision suffers from many inequities:

- It taxes a loan, though it may be quite a genuine one (e.g. advance for purchase of goods/services), which is duly repaid within its scheduled short time. Moreover, there is no corresponding tax-relieving provision at the time of recovery of the loan.
- The tax is attracted, notwithstanding that the loan may be advanced at a fair commercial rate of interest and notwithstanding that preponderant majority of persons owning the concern which received the loan are not even shareholders of the lending company.
- It creates hindrances for cash pooling arrangements and common treasury management functions between group companies and impacts 'ease of doing business' for taxpayers.

Recommendations

- Levy of tax on deemed dividend in the hands of shareholder at the normal rate is unjustifiable especially when all other deemed dividends are also subjected to DDT. If this suggestion is not accepted, then adequate provisions should be made to exclude genuine transactions from the consequences of these provisions.
- Illustratively, genuine loans and advances, given on current market rate of interest and which are re-paid during the year, should be excluded from the scope of deemed dividend as these are not a subterfuge for payment of dividend.
- Loan given as part of business transaction and Inter-corporate deposits should specifically be excluded from the application of Section 2(22)(e) of the Act to avoid unnecessary litigation.

4.8.1. Accumulated Profits not to include Capital Reserves - Section 2(22)(e)

Issue

- As per the Companies Act, capital reserves cannot be utilized for distribution of dividend by a company. This leads to controversies as to whether capital reserves should form part of accumulated reserves for the purpose of Section 2(22)(e) of the Act.

Recommendation

- An amendment should be brought in Section 2(22) of the Act to exclude capital reserves from the ambit of "accumulated profits".

4.8.2. Taxability of Deemed Dividend in the hands of Recipient not being a Shareholder

Recommendation

- The object of sub-clause (e) of Section 2(22) of the Act is to prevent tax-avoidance by making an advance or loan (which would not be taxable), as a deemed dividend to the shareholder, which is subject to income tax. It is recommended that the threshold for substantial interest of the shareholder in the recipient concern should be increased to 51%.

4.9. Phasing out of Deductions and Exemptions

Some of the recommendations in relation to phasing of following profit linked incentives and weighted deduction by amendments in the Act made by the Finance Act, 2016 are as below:-

- Section 32 read with Rule 5 of Income Tax Rules, 1962 – Accelerated Depreciation

  The accelerated depreciation ranging mostly between 80-100% is available for certain block of assets such as renewable energy devices, air pollution control equipment, energy saving devices, etc. However, as per the announcement made by the Finance Bill, 2016, the highest rate of depreciation will now be restricted to 40% with effect from 1 April 2017. The accelerated depreciation on assets like computers, computer software, renewable energy devices, air pollution control devices, energy saving devices etc. is provided not as an incentive but considering their fast obsolescence due to rapidly changing technology. Accordingly such accelerated depreciation on environment saving/friendly devices should be retained. Further, such restricted rate should be made applicable only to the new assets acquired on or after 1 April 2017. At the very least, the highest rate of depreciation should be fixed at 60% in line with the Press Release issued by the Government in November 2015.

  It should also be clarified that in respect of taxpayer who may have qualified for higher rate of depreciation (but, in whose case, the depreciation relief was restricted to 50% since the asset was acquired in the latter half of the year) the taxpayer should be permitted to avail the balance depreciation as per old rates with regard to the unabsorbed portion.

- Sections 35(1)(ii), 35(1)(iia), 35(1)(iii), 35(2AA) and 35(2AB) - Expenditure on scientific research

  As per the aforesaid sections, the expenditure on scientific research is allowed as weighted deduction up to 125% to 200% of the expenditure incurred. The Finance Act, 2016 has made changes in the aforesaid sections by restricting the weighted deduction to 150% if it is currently more than 150% with effect from previous year 2017-2018 and to 100% with effect from previous year 2020-21. Further, where the weighted deduction is less than 150%, it is to be reduced to 100% from previous year 2017-18.

  It is well recognised that scientific research is the lifeline of business in all countries of the world. Indian residents are paying huge sums by way of technical services, fees to foreign technicians to upgrade their products and give the customers what latest technology gives globally. If In-house research is continuously encouraged, outgo on account of fees for technical services will reduce and this will help indigenous businesses to grow. Withdrawal of weighted deduction in respect of scientific research expenditure will put a dent to the 'Make in India' initiative of the Government. FICCI recommends that weighted deductions allowed under the Act at present to various modes of scientific research expenditure be continued. The Government can also consider introducing benefits in the form of research tax credits which can be used to offset future tax liability (similar to those given in developed economies).

- Section 35AC – Expenditure on eligible projects or schemes

  Any expenditure incurred on eligible projects or schemes for promoting the social and economic welfare of the society is allowed as deduction to the extent of the amount of expenditure under section 35AC of the Act. Rule 11K of the Income-tax Rules, 1962 ('the Rules') provides the list of projects which are eligible for deduction under section 35AC of the Act. The projects as mentioned in Rule 11K of the Rules are for the development of the economically and socially weaker sections of the society e.g.; construction of school and dwelling units for economically weaker sections of society etc. After the amendment made by the Finance Act, 2016 in section 35AC of the Act, no deduction shall be available for any expenditure incurred on eligible social development project or scheme on or after April 1, 2017. Corporates contribute huge sums for this cause under their responsibility towards the society and the environment as also to fulfil conditions relating to Corporate Social responsibility ('CSR') funding. The whole initiative for the rural development and the upliftment of the poor may take a backseat, if no deduction is made available under section 35AC of the Act.

  Further, the recent CBDT Notification NO. SO 1103(E) [NO.3/2016 (F.NO.V.27015/1/2016-SO (NAT.COM)], dated 15 March 2016 carries an exclusion that contributions received pursuant to CSR obligation shall not be eligible for deduction under section 35AC of the Act. This is contrary to the provisions of section 35AC of the Act read with Rule 11K of the Rules which do not contain any such restriction. It may be noted that Circular No. 1/2015 dated 21 January 2015 issued by CBDT explaining the amendments by Finance (No. 2) Act 2014, provides that the CSR expenditure which is of the nature described in section 30 to 36 of the Act shall be allowed as deduction under those sections subject to fulfilment of conditions, if any, specified therein. Hence, the exclusion provided in the aforesaid notification conflicts with the provisions of section 35AC of the Act and the Circular No. 1/2015 (supra).

  The expenditure incurred on eligible projects or schemes are for the development of the backward and weaker sections of the society. Further, all the projects are approved by the National Committee which is set up by the Central Government to ensure that the funds are utilized for the said purpose. Therefore, this deduction which is serving a useful purpose for which it was enacted, should be continued to be allowed at least for three more years. Further, the disqualification for CSR contributions in the aforesaid notification approving section 35AC projects should be immediately withdrawn and it should be clarified that CSR contributions to section 35AC approved projects are allowable as deduction under section 35AC of the Act.

- Section 80-IAB and 80-IB - Development of special economic zone (80-IAB), production of mineral oil and natural gas (80-IAB), development of special economic zone (80-IAB), production of mineral oil and natural gas (80-IAB)

  Section 80-IAB of the Act provides for phasing out of deduction under this section w.e.f. 1 April 2017 (FY 2017-18) w.r.t commencement of development. Determination of when development has commenced could become extremely subjective and litigation prone. Also, the developers made investments in the notified areas prior to 1 April 2017 with a belief that the deduction will be allowed on development of such SEZ approved by the government prior to 1 April 2017. Since the qualifying period of deduction starts from year of notification of SEZ, the phase out may also be with respect to SEZs notified on or after 1 April 2017 instead of current provision of phase out with respect to commencement of development on or after 1 April 2017.

  As per the amendment made by the Finance Act, 2016, no deduction under section 80-IB(9) shall be allowed to an undertaking which begins commercial production of mineral oil or natural gas on or after 1st April, 2017. It may be noted that many companies have acquired blocks under the scheme eligible under section 80-IB(9) of the Act by the dates specified in the section. It is well known that the discoveries in the blocks acquired take a very long time and the explorers have to conduct discovery exercises for many years before they are successful

in obtaining commercial production. Those who invested in the blocks rightly believed that the deduction will be allowed if the blocks were acquired under the eligible scheme and the Government intends to allow the deduction for seven years from the year in which commercial production begins. The withdrawal of deduction for the assessees commencing commercial production on or after 1 April, 2017 will put the investors of the blocks to a disadvantage. The sunset clause in section 80-IB(9) of the Act be made with reference to acquisition of new blocks and for commencing discovery process in such block already acquired. It is further recommended that the sunset clause may not be made applicable for blocks in which the discoveries have already commenced although commercial production may have not commenced before 1 April, 2017.

- Section 35CCC – Expenditure on Agricultural Extension Project

  Agricultural productivity in India is among the lowest in the developing countries. Agricultural Extension work plays an important role in educating and making farmers use the resources better thereby improving their income and wellbeing. To bring in participation from all organisations in to this project the Government announced tax incentive in the form of weighted deduction on agricultural extension projects. The initiatives were only recently launched and need to be continued for a reasonable period of time to give desired results. The private sector including corporates have planned and applied for recognition of such projects and had also invested significantly in selected projects. In such a situation the proposal to withdraw the weighted deduction on agricultural projects is unwarranted.

Recommendation

It is recommended that the weighted deduction given for expenditure on agricultural extension projects be continued.

- Other Issues and Recommendations

  The provisions of MAT were introduced as a result of certain deductions and exemptions available to the taxpayers under the Act. While introducing MAT provisions, it was mentioned in the memorandum explaining the provisions of the Finance Bill 1987 that certain companies making huge profits were managing their affairs in such a way as to avoid payment of income tax. Basic purpose of introducing MAT was to bring all zero tax companies within the tax net. It was introduced to neutralize the impact of incentives. It is recommended that with phasing out of incentives, the Government should consider reducing the burden of MAT on the taxpayers and MAT should eventually be phased out.

4.10. Income Computation and Disclosure Standards ('ICDS')

On 31 March 2015, the Government had issued 10 Income Computation and Disclosure Standards (ICDS), operationalising a new framework for computation of taxable income by all assessees in relation to their income under the heads 'Profit and gains of business or profession' and 'Income from other sources'. These standards were to be applicable for Previous Year (PY) commencing from 1 April 2015, i.e., Assessment Year (AY) 2016-17 onwards. Based on various representations made by the stakeholders at large, the Expert Committee was constituted to examine stakeholder's representations and the Committee recommended for amendments to be made to the notified ICDS as well as issuance of clarifications in respect of certain points raised by the stakeholders. The Government vide Press release dated July 6, 2016 announced revision of ICDS and deferment of ICDS for one year and to be applicable from April 1, 2016 instead of April 1, 2015. Recently, CBDT through its notification no. 87/2016 dated September 29, 2016 has notified revised ICDS and repealed its earlier notification no. 32/2015 dated March 31, 2015.

Issues

- It is observed that there is no international precedent on ICDS. ICDS at best leads to timing difference between accounting and taxable income.

- Taxpayers are already grappling with multiple regulatory changes like Companies Act, Ind-AS and GST. There is also scope for litigation on many aspects of ICDS. Further, ICDS merely results in multiplicity of accounting methods, increased compliance burden of multiple records, etc. which outweigh the benefits to be gained by application of ICDS.
- ICDS has deviated from recognised accounting principles viz. materiality and prudence. It alters the settled legal positions and will add to enormous litigation.
- The revised ICDS were notified by the Government on September 29, 2016 leaving no time for the taxpayers to analyse the impact of the same.

Recommendation

It is recommended that ICDS should be withdrawn or at least provisions of ICDS should be deferred for a reasonable period of time so that the taxpayers and the tax authorities get sufficient time to be fully equipped to comprehend the scope and reach of ICDS in a better manner.

4.11. Place of Effective Management

The Finance Act, 2015 has modified the condition of determining residential status of a company. A company will now be resident in India if it is an Indian company; or its place of effective management in that year, is in India. Place of effective management ('POEM') means a place where the key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made. The Finance Act 2016 has deferred the provisions of Place of Effective Management (POEM) by 1 year i.e. to be effective from Financial Year (FY) 2016-17.

Issue

CBDT issued draft guiding principles for determination of POEM of a company. While the purpose of the guiding principles is to reduce the subjectivity as to what constitutes POEM in India, and to have greater certainty as to the existence or non-existence of a POEM in India, it appears that the draft guiding principles are too subjective in nature, and leave too much room for interpretation. FICCI had made a detailed representation in regard to the draft guidelines. The final guidelines are still awaited. The next financial year is to start and many of the concerns (Referred in the Memorandum Explaining the provisions of the Finance Bill, 2016) and those highlighted in the submissions made to the Government on the draft guiding principles) may still persist especially since the final guidelines have not been issued so far.

Further transitional provisions on matters like past losses, WDV of assets etc. of companies which are held to be resident of India under the POEM test have also not yet been prescribed, despite the statutory framework in this regard having been put in place under the Finance Act, 2016. The absence of these norms adds to the uncertainty over the implementation of POEM.

Recommendation

In the above background, it is recommended to defer the provisions of POEM appropriately so that the taxpayers have reasonable time to study the final guidelines, assess its full impact and to make necessary structural changes, if required.

4.12. Patent Box Regime – Section 115BBF

The Finance Act, 2016 introduced a new provision under which income earned by a qualifying taxpayer from the exploitation of a patent would be taxed at a preferential rate of 10%. No deduction of any expenditure or allowance would be allowed in computing the income under this regime, and the income qualifying for the preferential rate should be by way of royalty in respect of a patent developed in India. 'Eligible taxpayer' has been defined to mean a person resident in India, who is the true and first inventor of the invention and whose name is entered on the patent register as the patentee in accordance with Patents Act, 1970.

(a) True and First Inventor

Issues

- The benefit of provision is restricted to 'true and first inventor of the invention'. Even a person who is jointly registered with 'true and first inventor' should be treated as 'true and first inventor'.
- In view of following features under the Patent law, the benefit of the provision may be denied to firms/LLPs/ companies who register the patents jointly with 'true and first inventor' who may be an employee even though they may have incurred significant expenditure for development of the patent and they are first economic owners of such patent
    - o Under the Patents Act, following persons can apply for patent (a) a person claiming to be true and first inventor of the invention (b) an assignee of the true and first inventor in respect of right to make an application and (c) legal representative of a deceased person who immediately before his death was entitled to apply.
    - o It is also settled under the Patent Act that a company or firm cannot claim to be 'true and first inventor'. They can only apply as assignee of true and first inventor.

Recommendation

- It is, hence, recommended that the condition of joint patentee also being 'true and first inventor' be omitted. If the intent is to allow benefit only to first person to register patent, the phrase 'being the true and first inventor of the invention' used in context of joint person may be substituted with the phrase 'being the assignee of the true and first inventor in respect of the right to make an application for a patent'.

(b) Patent Registered in India as also in a Foreign Country

Issues

- The requirement of patent being registered in India under the Patents Act raises an ambiguity whether royalty received from overseas in respect of patent which is registered both in India and outside India will be denied the benefit on the ground that the royalty is relatable to foreign patent and not Indian patent.
- It may be noted that Patent law is territorial in nature and the exclusive rights cannot be exercised in any country unless the patent is registered in that country as per local patent law.
- The condition of patent being developed in India ensures that the benefit of PBR is restricted to inventions which are developed in India. Benefit should not be denied for royalty received from overseas countries for the same invention by registering it outside India.

Recommendations

- It should be clarified that royalty received from overseas for a patent which is registered in India as also in a foreign country also qualifies for concessional rate of tax. The benefit should not be denied on the ground that such royalty is attributable to foreign patent.

(c) Benefit of Patent Regime be allowed to Successor

Issue

- There is no provision in section 115BBF of the Act for continuation of the concessional rate of tax to the successor in case of tax neutral mergers and demergers and/or succession by way of slump sale or death of the inventor which may result in unwarranted denial of benefit and impediment to ease of doing business.

Recommendation

- In case of a business re-organisation in the form of merger, demerger etc., the successor entity and in case of death of the patent owner, its legal heir/inheritor of the patent should be considered as eligible to claim the benefit provided such successor/legal heir satisfies the condition of being a resident of India.

(d) Extend benefit to Royalty Income in respect of Patents applied but Registration awaited

Issues

- Royalty from a patent which is 'registered' alone qualifies for the patent box regime. If royalty income is earned when patent application is filed but registration is awaited, there may be unwarranted denial of the benefit.
- Under the current process of Patent Law, it takes minimum of 5 to 6 years for a patent to be registered but the registration relates back to the date of filing application. But it is possible for the inventor to license out the invention and start earning royalty from the date of application.
- If benefit is denied on the ground that patent is applied but not registered, there is no back up provision to grant the benefit for earlier years when the patent is finally registered.

Recommendations

- Hence, it is recommended that the concessional tax regime be extended to royalty income earned from patents which are applied for and awaiting registration as well.
- Alternatively, amendment may be made in the Act to provide that assessments for the period of royalty earned between the date of application to the date of registration shall be rectified to grant the benefit without any time limit once patent is registered.

(e) Extend benefit to Capital Gains arising in the hands of the Taxpayer

Issues

- The concessional tax rate is not applicable in respect of royalty received as capital gains. The taxpayer may exploit the patent by outright transfer which has no differential impact merely because for one assessee the amount is assessable as business income whereas for other it is assessable as capital gains income. There is no reason to exclude amount which is chargeable as capital gains in the hands of the taxpayer.
- At present the benefit of concessional regime is not extended to the sale of those products which have patent embedded in them. If the benefit is not extended to sale of patented products, it will result in absurdity viz. exploitation by way of licensing to outsiders is provided benefit but self-exploitation is denied benefit.

Recommendations

- It is recommended that concessional regime should also be extended to capital gains arising in the hands of the taxpayer on account of patent.
- It is recommended that the concessional regime should also be extended to income on sale of patented products also.

(f) Extend Benefit to other Intellectual Property Rights

Issue

Section 115BBF of the Act provides the benefit of reduced rate of tax to only royalty income derived from patents subject to specified conditions. This may partly achieve the intended objective of the government behind introduction of this provision i.e. to encourage indigenous research & development activities and to make India a global R & D hub.

Recommendation

The current income tax law treats other intellectual rights like any know-how, copyright, trade-mark, license, franchise or any other business or commercial right of similar nature in the same vein as patent. Hence, there appears to be no reason not to extend the benefit of section 115BBF to income from other intellectual property rights.

It is recommended that the benefit of concessional rate of tax of 10% of income by way of royalty in respect of a patent developed and registered in India be also extended to other intellectual property rights like know-how, copyright, trademark etc.

(g) Extend the Benefit from Self-exploitation of Patents by Manufacture and Sale of Articles

Issue

Section 115BBF of the Act provides the benefit of reduced rate of tax to only 'royalty' income derived from patents. This suggests that companies which hold patents and exploit them commercially by manufacturing and selling goods / articles may not qualify for the PBR, since they do not earn 'royalty' income per se. This will necessitate division of businesses into patent holding companies and companies that exploit the patent, which is artificial and serves no commercial purpose.

Recommendation

It is recommended that a concessional rate be extended to companies that exploit their own patents in the manufacture and sale of articles, by imputing a 'royalty' income determined on the basis of the arm's length principle.

4.13. Equalisation Levy

The Finance Act, 2016 has introduced a new levy of tax (termed as Equalisation Levy) on certain specified services. Equalisation Levy shall be 6% of the amount of consideration for specified services received/receivable by a non-resident (not having a Permanent Establishment in India) from (a) a person resident in India or (b) a non-resident having a PE in India.

Specified services has been defined to mean online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement and any other services notified by the Central Government.

Issues

- The Vienna Convention, which lays downs the fundamental principles for applicability of tax treaties, states that the tax treaties are binding on countries and must be honored in good faith. Since the equalization levy is essentially in the nature of a tax on income and hence, should ideally qualify within the meaning of the term 'taxes' under India's tax treaties, applicability of this levy in situations where the tax treaties provide taxing rights only to the country of residence (such as where the recipient earns business income and does not have a PE in India) goes against the fundamental principles of bilateral treaty negotiations. Levying income tax outside of Tax treaties overwrites the tax treaties unilaterally and will lead to double taxation.
- Foreign digital advertising companies operating in India through Indian establishments who act as reseller/ distributor of digital ad space i.e. purchasing online ad space from offshore and selling to the advertisers in India. The Indian establishments pay both income tax and service tax in relation to such digital advertisements. Indian establishments pay income tax on its profits which is determined in accordance with Income Tax/Transfer Pricing regulations in India. Once Indian establishment is paying income tax on its India activities, levying Equalisation levy on payment for purchase of online Ad space is clearly levying additional income tax on the same income. Exemption from this levy has been granted to Permanent Establishments (PE) because PE will be paying income tax based on activities performed in India. Similarly Indian establishments acting as a reseller/ distributor of digital advertisement space is paying income tax based on activities performed in India.

- The equalization levy at the rate of 6 percent on gross consideration received or receivable by a non-resident (in the absence of a PE) is too high. An equalization levy of 6 percent on gross basis would mean a profit attribution of around 47 percent[1] to Indian activities (considering a profit margin of 30 percent and tax rate of 43.26 percent), which is an unreasonably high amount of attribution to India, considering the fact that the only nexus with India is on account of the fact that the customers are located in India. The actual income-generating activities of the non-resident are the technology/product and functioning of the same on the data centers/ servers/ other infrastructure on a real-time basis, which are all carried out outside India.
- The equalization levy is not chargeable in cases where the non-resident service provider has a PE in India. However, it could be possible that the payers would have deducted equalization levy on the understanding that the non-resident does not have a PE in India (as required under the equalization levy chapter) and subsequently, the Indian tax authorities allege a PE of the non-resident and demand income-tax under the Act on the income attributable to the PE. In such cases, since equalization levy does not form part of the Act, credit for such levy may not be available against the income tax demand raised by the Indian tax authorities under the Act. This could potentially lead to double taxation of income in the hands of the non-resident service provider.
- The levy is applicable in case of payments made by a person resident in India carrying on business, irrespective of whether the payments are made for carrying on a business in India or outside India. The scope of the levy appears to include payments made by resident for overseas business activities. The applicability of the levy could be viewed as 'extraterritorial' and could lead to protracted litigation.
- The levy is applicable to payments made for, inter alia, 'online' advertisement. The term 'online' has been defined to include facility/service etc. obtained through the internet or any other form of digital or telecommunication network. The scope of the term 'online' appears to be wide and could possibly even cover advertisements placed on foreign television channels.
- There is no clarity on the applicability of the levy on cross charge received by Indian entities from their overseas parent for various group services.
- There is no specific provision for filing appeal against intimation of processing of annual statement of equalization levy.
- Lastly, the trend of India levying additional tax (such as the Dividend Distribution Tax, the Buyback Tax and now the Equalisation levy) on Indian nationals significantly adds to the tax burdens on Indian businesses.

Recommendations

- There is a need to take a re-look on the validity of the Equalisation levy.
- Exemption from the levy should be granted to Indian establishments of non-resident digital companies who distribute online ad space in India to avoid double taxation in India.
- The levy should be introduced though a separate provision in the Act to address the issue of resultant double taxation in the hands of the Foreign Service provider due to non-availability of its credit in the foreign jurisdiction. This would enable a non-resident service provider to claim credit of Equalisation Levy paid in India against corporate Income-tax to be paid in the country of residence of such non-resident, subject to the domestic law provisions of the non-resident country. As an alternative, section 90(2) of the Act should be made applicable to Chapter VIII, which will allow the non-resident to claim beneficial provisions of the tax treaty.

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[1]Assume an advertiser in India makes a payment of INR 100 towards online advertisement to non-resident foreign company:
Equalization levy @ 6 percent on consideration (INR 100) = [100*30 percent (Profitability)] X [47 percent attribution to India] X [43.26 percent tax rate on foreign companies]

- Enabling provisions to allow non-residents to claim refund of the levy, non-applicability of the levy, appeals, etc. should be introduced in the Chapter VIII.
- The rate of levy should be brought down to 1% on gross basis due to wafer thin margins and since the digital ecosystem players are primarily being start-up companies facing losses in initial years.
- Enabling provisions be introduced to facilitate non-residents having losses, to apply for nil/lower equalization levy certificate. Payer should be granted a mechanism to apply to the local tax officer to determine whether the transaction is subject to Equalisation Levy or withholding tax provisions under the Act. Accordingly, payer should be allowed to make an application to the tax officer in advance for determining whether it should deduct Equalisation Levy or withholding tax at appropriate rate.
- It is requested that the abovementioned issues on the applicability of levy on revenues received from advertisements placed in foreign television channels, advance payments, cross charges be clarified by the Government.
- The levy should not be made applicable to payments in respect of services utilized for carrying the business or profession outside India.
- Specific provision be introduced for appeal to be made against intimation of processing of annual statement of equalization levy.

4.14. Rationalization of provisions of Section 14A and Rule 8D

As per Section 14A of the Act, no deduction shall be allowed in respect of expenditure incurred in relation to income not includible in the total income. Section 14A(2) of the Act provides that the amount of expenditure incurred in relation to income not includible in the total income shall be determined by the tax officer if he is not satisfied with the correctness of the claim of the taxpayer in respect of such expenditure in relation to income not includible in the total income. This satisfaction is to be arrived at by the tax officer having regard to the accounts of the taxpayer. The determination of the amount of expenditure incurred in relation to the income which is not includible in the total income of the taxpayer is to be done in accordance with the method prescribed, i.e. Rule 8D of the Rules. There has been a spate of litigation on the application of the section, illustratively, with respect to issues related to the quantification of the amount of expenditure attributable to exempt income, identification of exempt income.

Issues

- In pursuance of recommendation by Income Tax Simplification Committee, the CBDT vide Notification No. 43/ 2016 dated June 02, 2016 partially substituted existing Rule 8D for computing disallowance of expenditure incurred in relation to exempt income. The modified Rule provides for a new method for computation of disallowance of expenditure which, in addition to amount of expenditure directly relating to exempt income, shall include an amount equal to 1% of the annual average of the monthly average of the opening and closing balances of the value of investment which gives rise or may give rise to exempt income. Rule 8D further provides that the total amount of disallowance shall be restricted to total expenditure claimed by taxpayer. However, it has been noticed that even if exempt income is not earned during a particular year, the tax officers disallow the expenditure in relation to the investments which have the potential to earn tax exempt income.
- Further, dividend which is subject to DDT and share of profit from partnership firm which has been subject to tax in the hands of partnership firm should not be treated as exempt income and corresponding expenditure should not be disallowed under section 14A of the Act.

Recommendations

- It should be explicitly clarified that disallowance under section 14A of the Act should not be triggered if no income which does not form part of the total income under the Act has been earned in a particular year.
- Clarity be provided on the term 'Total Expenditure claimed by the assessee' in the amended Rule 8D.
- Share of profit from partnership firm in the hands of partner, Dividend income in hands of shareholders, income arising to shareholder on account of buy-back of shares, income arising to a unit holder in respect of units of a Mutual Fund, specified undertaking, specified company, distributed income referred to in section 115TA of the Act received from securitisation trust by any person being an investor of the said trust and which has been already subject to tax should not be treated as exempt income and corresponding expenditure should not be disallowed under section 14A of the Act.
- It is recommended that the provisions of section 14A of the Act be amended to specifically provide that the Assessing Officer should adequately record satisfaction as to applicability of the provisions of section 14A of the Act before the same is invoked.

4.15. Taxation of Subsidies

The issue of whether subsidies received by a taxpayer are 'income' under the Income-tax Act, 1961 has been the subject matter of some litigation historically. However, based on judicial pronouncements over the years, the law had evolved such that only subsidies granted to meet revenue expenditure or losses were considered as 'income'. Subsidies granted for incentivising the setting up of new units in backward areas or otherwise were considered to be of a capital nature.

This longstanding position was overturned by the amendment to section 2(24) made by the Finance Act, 2015. A new clause (xviii) has been inserted as a result of which any assistance in the form of *subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement* by the Central or State Government or any authority or body or agency will be considered 'income' and liable to tax.

The negative impact of such an amendment on the various initiatives launched by state governments over the years to incentivise investments in backward regions of their respective States cannot be understated. It goes without saying that such incentives whether in the form of concessional land, sales tax incentives, reduced stamp duties etc. act as a powerful stimulus to investments in such regions. A levy of income-tax on the value of such benefits will result many projects becoming unviable, thus affecting the success of the 'Make in India' initiative. The State governments will be required to effectively gross-up the quantum of incentives if their existing schemes are to retain their attractiveness.

Such a provision runs contrary to the Government's stated principle of empowering states. The levy of tax by the Centre on incentives given by States in essence amounts to a reverse resource transfer from the States to the Centre which runs counter to the objective of cooperative federalism advocated by the Government and the NITI Aayog.

It is therefore submitted that this provision be dropped and the position prevailing before the amendment be restored. Alternatively, at the minimum, appropriate clarifications are urgently required so as to provide taxpayers with certainty as to the specific incentives that are sought to be covered within this provision.

4.16. Treatment of Revenue Equalization Reserve

Issue

As per Accounting Standard - 19, Lease Revenue with respect to assets given on operating lease should be credited to the Profit and Loss Account on straight line basis over the lease term. Thus, even though the income is not contractually due during the year (since such income will become due only in future years), the accounting standard mandates recognition of income on straight line basis. However, it has been observed that the 'lease equalisation reserve' created

due to the difference between accounting income and taxable income is not allowed as a deduction while computing the taxable income. This difference is just a notional income in the nature of a timing difference which is booked to comply with the accounting standard and taxing of this income goes against the principle that only real income should be taxed.

Recommendation

It is recommended that the Government should issue an instruction to clarify that tax cannot be levied on notional income and that only real income should be charged to tax.

4.17. Issues related to allowability of certain Expenditures, Deductions and Disallowances

4.17.1. Depreciation – Section 32

Issues

There is no clarity on allowability of depreciation on finance lease transaction. In various judicial precedent it is been upheld so long as the transaction is accepted to be a 'lease' and not a 'loan', the lessor should be entitled to depreciation regardless of whether the lease is classified as 'operating lease' or 'finance lease' in books. But in absence of clear & objective guidance to distinguish between a 'loan' and 'lease' transaction, litigation has continued on allowance of depreciation to lessor. In some cases, depreciation has been denied to both lessor and lessee. Suitable legislative clarifications in this regard would go a long way to minimise litigation and providing certainty to the taxpayers.

- Allowability of depreciation on toll rights in Build, Operate and transfer (BOT) projects in roads. CBDT Circular No. 9 /2014 dated 23 April 2014 states that while no depreciation can be allowed since toll road does not belong to the BOT operator, the taxpayer is entitled to amortised deduction over the toll period. As per Companies Act, 2013, toll right constitutes 'intangible asset' which qualifies for amortised deduction based on pro-rata projected revenue over the toll period. Specific clarity needs to be provided on this aspect.
- Oil wells are classified as buildings and therefore, depreciation at a less rate of 10% is allowed on the same.
- Need for Higher depreciation for plant and machinery.
- Whether 'non-compete fee' can be regarded as 'any other business or commercial right of similar nature', to be eligible for depreciation as 'intangible asset' under Section 32 of the Act.

Recommendations

- The Government should provide clarity in respect of person who can claim depreciation on leased assets under operating lease, finance lease, sale and lease back and other financing arrangement by laying down objective rules.
- It is requested that it may be specifically clarified that right to collect toll or charges or annuity for using infrastructure facility is an 'intangible asset' and allow depreciation under the Act consistent with accounting treatment as per Companies Act.
- Oil/Gas well should be classified as 'Plant and Machinery' for mineral oil concerns eligible for special rate of 60% depreciation. However, tax officers consider oil well as building and allow depreciation @10% as against eligible rate of 60% applicable to such plant & machinery relying on the definition given in notes forming part of Appendix – I "Table of rates at which depreciation is admissible'' wherein 'building' has been defined to include roads, bridges, culverts, wells and tube wells. Tax officers consider that oil well is also covered as building since it is an inclusive definition.

Oil wells are not normal well and require special equipment, knowledge and skill which go into developing oil well. Therefore, one cannot consider oil well as same as any water well. Oil well is made up of various machineries and 'cementing' is just one process to strengthen the structure of such well and therefore by no means oil wells can be considered as building. It is recommended that a necessary clarification by way of circular may be issued by the Government to the effect that oil/ gas well be classified as 'Plant and Machinery' for mineral oil concerns eligible for special rate of 60% depreciation.

- It would be in fitness of things to restore the rate of depreciation on general plant and machinery to 25% from 15% to encourage investment in new plant and machinery entailing up-gradation of obsolete technologies.
- Moreover, the Government should extend the initial depreciation under Section 32(1)(iia) of the Act to service industries as well which is currently available to only manufacturing sector.
- There is a lack of clarity as to whether payment made for non-compete fees shall be eligible for depreciation under Section 32 of the Act as 'intangible assets', which has given rise to unintended litigation. It is therefore, suggested that a clarificatory amendment should be made in Section 32(1)(ii) of the Act to include non-compete fee within the definition of 'intangible asset'.

4.17.2. Investment Allowance - Section 32AC

The Finance Act (No. 2), 2014 has amended Section 32AC of the Act, wherein the taxpayer shall be allowed a deduction of 15% of cost of new plant and machinery, for investment made up to 31 March 2017, if such investments are more than Rs. 25 crore in a FY. Further, the taxpayer eligible to claim deduction under the earlier combined threshold limit of Rs.100 crore for investment made in FYs 2013-14 and 2014-15 shall continue to be eligible to claim deduction even if its investment in the year 2014-15 is below the new threshold limit.

Issues

- The phrase 'manufacture or production of an article or thing' has not been defined in Section 32AC of the Act which can entail litigation.
- The Memorandum explaining the provisions of the Finance Bill, 2013 states that the proposed investment allowance is meant for a company engaged in the business of manufacture of an article or a thing. However, other sectors like developing and building an infrastructure facility, telecom infrastructure service providers, processing/ assembling activities, creation of broadband facility are equally important for the growth of the Indian economy. Similarly, the investment allowance should be allowed for the other sectors for the overall growth of the economy.
- New asset for the purpose of Section 32AC of the Act would not include any office appliance including computers and computer software. It may be noted that the computers and computer software such as servers, ERP systems etc. are intended to enhance overall operational efficiency. Given that India is considered a global powerhouse in the IT / ITeS space, it is ironical that modern technologies tools such as computer and computer software are excluded though they bring about efficiency in manufacture and production of goods.
- The benefit intended to be provided by way of grant of investment allowance under Section 32AC of the Act would get diluted on levy of MAT under Section 115JB of the Act.
- There is ambiguity as to whether the unutilized investment allowance (in case there is no sufficient income to absorb the investment allowance) would be carried forward to the next year or not.
- One of the eligibility criteria for grant of investment allowance under section 32AC(1) is that the taxpayer must 'acquire and install' the new plant and machinery in the year of claim i.e. after 31 March 2013 but before April

1, 2015. It is justifiable that 'acquisition and installation' of such a large amount of investment may not be completed within a short span of two years. Large capital intensive project normally take at least three to four years to get installed. In such cases, the benefit is lost which is not the objective behind the introduction of the investment allowance. The Finance Act, 2016 has liberalised the twin condition of "acquisition" and "installation" of assets in the same year in respect of new assets acquired during previous year 2015-2016 to 2016-2017 if such assets are installed before March 31, 2017 by making an amendment in section 32(1A) of the Act.

- The minimum limit of investment in new plant and machinery for a company to claim investment allowance under section 32AC(1A) of the Act is Rs. 25 crores in a span of two years. However, MSMEs have not been able to avail the benefit of investment allowance because as per the MSMED Act 2006 the limit of defining MSMEs in manufacturing sector is based on their investment in plant and machinery which has an upper ceiling of 10 crore.

Recommendations

- The allowance under Section 32AC of the Act should also be extended to other sectors of the economy like those in operating developing and building an infrastructure facility, telecom infrastructure service providers, processing/assembling activities, creation of broadband facility, and conversion of LNG into RLNG etc. This will truly provide a fillip to the economy and will meet the true intent of the provisions. Specific amendment to extend benefit of the investment allowance to service companies as well as infrastructure companies be made.
- Further, it is not clear if deduction under this Section is applicable to IT (Information Technology)/ITES (IT Enabled Services) companies using various kinds of computers/ data processing machines to manufacture/develop software. Therefore, it is suggested that an explanation be inserted under Section 32AC to extend such benefit to IT/ITES companies engaged in 'manufacturing' or 'developing' of software. Also, the definition of "new assets" under Section 32AC of the Act should be amended to cover 'computers or computer software used by IT/ITES companies for manufacturing/development of software'.
- The investment allowance eligible for deduction under Section 32AC of the Act should be reduced while computing book profits of the company under the provisions of Section 115JB of the Act.
- Specific provisions for carry forward and set off of investment allowance for an indefinite period should be brought in the Act.
- The scope of 'manufacture or production of any article or thing' and terms 'acquired', 'installed' be clearly defined to avoid any potential litigation on interpretation and implementation of the provision.
- It may be clarified that the deduction under section 32AC(1) of the Act will be granted as long as new plant and machinery exceeding Rs. 100 crores is acquired after March 31, 2013 and installed within the block of specified years (3 years) irrespective of the fact that acquisition and installation of new assets falls in different financial years.
- It is recommended that the investment limit for MSMEs should be reduced suitably to enable them to take the benefit under section 32AC of the Act or a specific provision be introduced in the Act for MSMEs.

4.17.3. Amortization of certain Preliminary Expenses - Section 35D

Issues

- Section 35D of the Act provides deduction to resident taxpayers for certain expenditure incurred before the commencement of business or after the commencement in connection with the extension of the undertaking or in connection with setting up a new unit. The benefit of deduction under Section 35D of the Act is limited to the specified expenditure such as legal charges, registration fees etc. incurred for incorporating the Company.

- Further, the deduction of this expenditure is restricted to 5% of the cost of project or capital employed at the option of the Company.
- However, legitimate expenditure incurred post incorporation for and until setting up of business, which are neither covered within Section 35D nor can be capitalized to the actual cost of fixed assets, gets permanently disallowed under the provisions of the Act and becomes a dead cost for the taxpayers even though they are incurred for the setting up of the business. Some of this expenditure could be office/ sales employees' salary, audit fees, advertisement and business promotion expenditure incurred prior to setting up of business, etc.
- This is more particularly in the case of companies having longer gestation period for setting up their business such as manufacturing entities, insurance business requiring multiple licenses, etc. This affects the cash flow and the spending capacity of the company.

Recommendations

- There is no plausible reason for not allowing these expenses as deduction either as revenue or on a deferred basis in five equal instalments. Therefore, Section 35D of the Act should be suitably amended to include all the expenses incurred by Companies post incorporation but during the course of setting up of its business as eligible for deduction.
- Even the ceiling of 5% should be removed as there is no rationale behind having such ceiling when the actual expenditure is far higher.

4.17.4. Tax treatment of Corporate Social Responsibility Expenditure – Section 37

Issues

- One of the highlights of the Companies Act, 2013 is that every company meeting the specified threshold would need to mandatorily spend 2% of their 'average net profits' on Corporate Social Responsibility (CSR).
- As per the Finance (No. 2) Act, 2014, the expenses incurred by the taxpayer on the activities relating to CSR referred to in Section 135 of the Companies Act, 2013 shall not be deemed to be incurred for the purpose of business and hence, shall not be allowed as a deduction under Section 37(1) of the Act.
- The corporate sector spend is effectively assisting the Government in undertaking social projects for the country. Therefore, making an express provision for not allowing a deduction is unfair. Even if deduction is allowed, it means that 66% of the cost is anyway being borne by the contributing corporate entity.

Recommendation

- It is recommended that the Explanation 2 to section 37 of the Act should be omitted and a deduction of CSR expenses incurred by the taxpayers pursuant to provisions of the Companies Act should be allowed under section 37 in computing business income.

4.17.5. Allowability of Annual Contribution to an Approved Gratuity Fund by the Employer

Issue

AS-15 requires that provision for gratuity should be made on the basis of actuarial valuation which is a scientific method of computing estimated liability by considering various yardsticks such as length of service, salary progressions, rate of discounting, age of employee etc. Section 40A (7) of the Act provides for deduction of provision made for contribution to an approved Gratuity fund. However, Rule 103 of the Rules restricts the ordinary annual contribution to 8.33 per cent of the salary of each employee during each year.

Gratuity payable on the balance sheet date as per Actuarial Valuation most of the times exceeds the 8.33 per cent of the current salary of an employee as the same is computed based on various factors considering period of length, increase in salary, retirement age, mortality, discounting rate etc. However employer does not get deduction for the payment to an approved gratuity fund more than 8.33 per cent of the salary of each employee. This restriction acts as deterrent to contribution to approved Gratuity fund.

Recommendation

It is recommended that Rule 103 of the Rules be amended to provide flexibility in ordinary annual contribution to approved fund by the employer as per the actuarial valuation.

4.17.6. Disallowance - Section 40(a)

Issues

- The Finance Act (No 2), 2014 amended Section 40(a)(ia) of the Act to provide that if specified payments to residents are made without TDS, it will result in disallowance of only 30% of the such payments and the payer is considered as an assessee in default. Prior to FY 2014-15, entire amount (instead of 30%) of the specified payments on which tax was not deducted was disallowed under Section 40(a)(ia) of the Act. There is an interpretation issue that whether an expenditure which suffered 100% disallowance prior to this amendment for default in TDS in earlier financial year will now be allowed only to the extent of 30% in the year of payment of TDS on account of strict reading of proviso to section 40(a)(ia) of the Act.
- It has also been observed that in a case where there has been partial compliance with the tax withholding provisions (say, tax may have been withheld @2% as opposed to the correct rate of 10%), still, the disallowance is imposed with reference to the entirety of expenditure rather than on a proportionate basis. While there are certain decisions which have held that no disallowance can be made in case of short deduction of tax, the Kerala HC in the case of CIT v. PVS Memorial Hospital Ltd (380 ITR 284)(Ker) has taken a strict view that full disallowance will apply if there is short deduction. Hence, this issue requires clarity and resolution at the earliest to avoid further litigation.
- No disallowance shall be made and the taxpayer shall not be treated as an assessee in default, where the resident payee has paid the taxes due on such receipt and furnished evidence in support of this such as return of income for that year, a certificate from accountant to this effect etc. This benefit is only available in case of resident payees.

Recommendations

- It is recommended that the provisions of Section 40(a)(ia) should clarify that if, in earlier years, the disallowance of 100% was made, then 100% of the amount should be allowed as deduction on payment of such taxes to the Government Treasury during the subsequent years (instead of 30%).
- It is recommended that 30% disallowance should be restricted on the part of the payment on which the tax was not deducted/deposited at source and not of the entire payment.
- In order to align the two sub section (i) and (ia) of Section 40(a), it is also suggested that Section 40(a)(i) of the Act should be amended to provide the following:-
  - 30% disallowance, instead of 100% disallowance for amount paid/payable to non-residents,
  - no disallowance in cases where the due taxes have been paid by the non-resident payees subject to conditions as applicable in case of resident payees.

Issue

It has also been observed that the assessing officer during the course of the assessment proceedings disallow the expenditure under section 40(a)(ia) of the Act even in cases where the assessee has already been subject to TDS proceedings under section 201 of the Act and has not been treated as 'assessee in default' for failure to deduct or pay tax in accordance with the provisions of Chapter XVII of the Act. It is observed that if the assessee has been subject to detailed examination in respect of the compliances made by him under the provisions of Chapter XVII of the Act and no default is found by the TDS officer, then the assessee should not be subject to disallowance under section 40(a)(ia) of the Act.

Recommendation

It is recommended that suitable amendment should be made in section 40(a)(ia) of the Act to provide that no disallowance of expenditure will be made under this section for a previous year in which the assessee is not treated as an assessee in default as per the order passed by the TDS officer under section 201 of the Act .

4.17.7. Disallowance of Expenses incurred in favour of Members (Section 40(ba)

Issue

Section 40(ba) of the Act does not permit deduction in the hands of AOP of any interest, salary, bonus, commission or remuneration paid to member of AOP. In many cases, a consortium may be formed by two or more members to jointly bid for big projects wherein each of the members brings in his own expertise and resources. If the consortium is assessed as AOP, the AOP's profits are assessed at higher amount by disregarding the commercial understanding between the parties for sharing of profits after factoring in specialised services or expert knowledge made available by some of its members. This results in disproportionate sharing of tax burden between the members. Unlike section 40(ba), section 40(b) permits deduction for interest and remuneration paid to partners of firm/LLP as per partnership agreement up to specified limits. This enables the partners to share the tax burden proportionate to their contribution to the firm.

Recommendation

To provide level playing field between firms and AOPs, an amendment may be made in the Act to provide for non-application of section 40(ba) for payments towards specialized services [i.e. expert knowledge] rendered by consortium members subject to the condition that deduction of payments made by consortium to its members will be allowed only if the same has been considered as income by the members in their respective return.

4.17.8. Deduction of Employees' Contribution to Provident Fund etc. – Section 43B

Issues

- Section 43B of the Act allows deduction towards employer contribution to PF/any other fund for the welfare of the employees if the same is deposited up to the date of filing the return of income. However, deduction for employees' contribution to PF/ESI or any other fund is governed by Section 36(1)(va) of the Act which mandates that the employees contribution should be credited to the relevant fund by the due date specified under the relevant Act, rule, order or notification governing that fund. Differential tax treatment for employees' contribution and employer contribution to the same fund is discriminatory and has led to unwarranted litigation.
- Section 43B of the Act provides that outstanding interest which is converted into loan shall be allowed as deduction as and when converted loan is repaid. This leaves ambiguity for interest which is converted into equity share capital of borrower at the option of the lender since equity share capital is not repaid in ordinary course of business. Hence, there is a risk that the taxpayer may lose deduction of such interest in perpetuity.

- The Finance Act, 2016 has made an amendment to section 43B of the Act by including payment made to Indian Railways for the use of railway assets within the ambit of clause (g) of section 43B of the Act. The term “use of railway assets” should be clarified. Also the freight paid to railways should be kept out of the clause (g).

Recommendations

- It is therefore recommended that suitable amendment be made in the Act so as to bring the provisions relating to the Employees’ contribution towards employee welfare funds in line with the employer’s contribution towards such funds.
- It should be clarified that where interest payable is converted into any type of share capital, the same would amount to actual payment of interest for the purposes of section 43B of the Act.
- The term “use of railway assets” in clause (g) of section 43B of the Act should be clarified. Also, the freight paid to railways should be kept out of the purview of section 43B.

4.17.9. Exchange differences on Money borrowed in Foreign Currency

Issue

Section 43A of the Act allows an assessee to make adjustment in “actual cost” of the asset after the acquisition of assets from a country outside India on account of exchange rate fluctuation arising either on liability payable towards such foreign asset or on account of money repayable in foreign currency utilized for acquiring such foreign asset. The adjusted “actual cost” becomes the base for claiming depreciation. The provisions of section 43A of the Act does not specifically provide for such adjustment where the asset is acquired in India out of funds borrowed in foreign currency.

Recommendation

It is recommended that provisions of section 43A of the Act should be extended to allow for adjustment of foreign exchange fluctuation in “actual cost” even where the asset is acquired in India from foreign currency. This will not only bring parity between assets acquired from outside India and assets acquired within India but will also be in line with “Make in India” initiative of the Government. Alternatively, it is recommended that amendment be made in Section 43(1) of the Act to specifically provide for adjustment in “actual cost” on account of exchange difference on loan obtained from outside India but utilized to acquire assets in India.

4.17.10. Presumptive Tax Regime for Professionals – Section 44ADA

The Finance Act, 2016 has inserted section 44ADA in the Act providing for special provision for computing profits and gains of professionals on presumptive basis. As per section 44ADA, an assessee, being a resident in India, who is engaged in a profession referred to in sub-section (1) of section 44AA of the Act and whose total gross receipts do not exceed fifty lakh rupees in a previous year, a sum equal to fifty per cent of the total gross receipts of the assessee in the previous year on account of such profession or, as the case may be, a sum higher than the aforesaid sum claimed to have been earned by the assessee, shall be deemed to be the profits and gains of such profession chargeable to tax under the head “Profits and gains of business or profession”.

Issue

It is not clear as to how the gross receipts in the hands of professionals who are partners in professional firms have to be determined for the purpose of section 44ADA of the Act. As such partners of professional firms receive share of profit, interest and remuneration from the professional firm. They do not receive any amount from clients directly. Accordingly, if partners of professional firms are covered by provisions of section 44ADA of the Act, question that arises is that whether tax @ 50% shall be levied on the gross receipts which also includes share of profit which is otherwise exempt under section 10(2A) of the Act.

Recommendation

It should be specifically clarified that in case of partners of professional firms who are covered by section 44ADA of the Act, scope of presumptive tax scheme shall be restricted only to taxable gross receipts i.e. salary or interest, that too, to the extent the same is deductible in the hands of the professional firm. It should be specifically clarified that gross receipts shall not include share of profit exempt under section 10(2A) of the Act and hence, no tax shall be levied in the hands of partners under section 44ADA of the Act.

4.18. General Anti Avoidance Rule - Chapter X-A

The Finance Act, 2015 deferred implementation of General Anti Avoidance Rules (GAAR) by two years so as to introduce provisions of GAAR with effect from financial year 2017-18. Considering the current economic environment and efforts of the Government to attract FDI, GAAR should be further deferred. This will provide certainty to the investors and help accomplish the efforts of the Government to bring tax certainty. If Government decides not to defer GAAR, then following needs to be addressed on immediate basis:-

4.18.1. Key Recommendations of Shome Committee

- We wish to submit that the following clarifications/ conclusions provided in the Shome Committee report are truly salutary and exemplary and should be incorporated in the final Guidelines:-
    - As an overarching principle, GAAR to apply to abusive or highly aggressive/ contrived arrangements.
    - 'Choice principle' should be respected and should not be prone to GAAR (example, undertaking buy-back of shares instead of declaring dividends, acquiring asset on lease over outright purchase, funding by way of debt rather than equity, etc. are all business choices of a taxpayer and should not be subjected to scrutiny under GAAR).
    - Tax mitigation by taking advantage of a fiscal incentive and after complying with conditions of the section is not covered by GAAR.
    - Onus of proving each of the requirements of declaring the arrangement to be impermissible is on the tax authority.

  Examples to this effect should be provided for in the Guidelines.

    - It should also be accepted that GAAR cannot be considered to be a charging provision. While the application of a GAAR to impermissible tax avoidance may help to stem the tide of short term revenue loss, the GAAR itself cannot become a revenue raising measure. It should be intended to protect the tax base established by Parliament, not to expand it.
    - We humbly submit that adoption of these principles will provide substantial fairness in law and will substantially reduce unwanted litigation and hardship.

4.18.2. Grandfathering of Investments

- In line with the statement made by the Hon'ble Finance Minister in his Budget speech of 2015, the Central Board of Direct Taxes has issued a Notification dated 22 June 2016 extending the date for grandfathering of investments for the purposes of GAAR to 1 April 2017.
- Accordingly, any income from the transfer of investments made before 1 April 2017 will not be subject to GAAR. As regards other transactions (i.e. other than the transfer of grandfathered investments) GAAR will apply to any arrangement, irrespective of the date on which the arrangement was entered into, if the tax benefit from that arrangement is obtained on or after 1 April 2017.

- We submit that there is a case for grandfathering all transactions made before 1 April 2017 (and all related tax aspects without confining it just to "income arising on transfer of such investments") considering the following:-
  - (a) The validity and legality of a prior arrangement ought to be tested with reference to the norms of jurisprudence and norms of tax avoidance as prevalent as on the date of arrangement.
  - (b) Evaluating validity of a prior structure based on a norm of tax avoidance which was not then in existence is nothing but retroactive application of the Chapter.
  - (c) Retroactive application to past transactions could also be alleged to be back door treaty override on unilateral basis by the Government.
- Thus, Rule 10U(2) of the Income Tax Rules, 1962 ('the Rules') which provides for retroactive application of GAAR should be deleted and Rule 10U(1) should be suitably modified to grandfather all transactions made before 1st April 2017 (and not just income arising on transfer of investments).

4.18.3. GAAR vs SAAR

- It was the recommendation of Shome Committee that under normal circumstances, where Specific Anti-Avoidance Rule ('SAAR') is applicable, GAAR will not be invoked. It has also been recommended that GAAR will not apply to a tax treaty which has a specific Limitation of Benefit (LOB) clause.
- The Press Release dated 14 January 2013 states that in a case where both GAAR and SAAR are in force, only one of them will apply to a given case and guidelines will be made regarding the applicability of one or the other.

  It is recommended that GAAR should be considered as a measure of last resort. It should not be invoked in a case where there is compliance with SAAR and the subject matter is already dealt with a SAAR. It is only in cases of exceptionally abusive behaviour that GAAR could be invoked in such a case.

4.18.4. GAAR in the context of Treaty Override

The provisions of section 90(2A) of the Act reads as under:-

> "(2A) notwithstanding anything contained in sub-section (2), the provisions of Chapter X-A of the Act shall apply to the assessee, even if such provisions are not beneficial to him"

It is apparent from the above provision that the domestic tax law expressly provides that GAAR provisions may result in tax treaty override.

At the outset, it is highlighted that the Double Taxation Avoidance Agreements ('DTAAs') are negotiated between two countries bilaterally after deliberate discussions/debates. Many DTAAs with India itself contain anti-avoidance/anti-abuse provisions. For instance, the Limitation of Benefit ('LOB') clause in various DTAAs (e.g.; India–Singapore DTAA, recently introduced in India–Mauritius DTAA, etc.).

Accordingly, to ensure consistency with the object and intent of the introduction of anti-abuse provisions in DTAA, it is recommended that GAAR guidelines may specifically provide that the provisions of treaty override in section 90(2A) of the Act should not be invoked where the treaty itself contains anti-avoidance and anti-abuse provisions (e.g.; LOB clause). It is submitted that primacy of tax Treaty over GAAR should be maintained and the arrangement entered after compliance of the conditions spelt out in treaty should be kept out of the provisions of the GAAR. Appropriate amendment to the Act would also need to be carried out to avoid ambiguity in interpretation.

4.18.5. Onus of Proof

- Shome Committee, in its report, favoured discharge of onus by the tax authority.
- However, vide Finance Act 2013, the words "unless it is proved to the contrary by the assessee" were inserted in section 96(2) of the Act.
- Section 96(2) stops at rebuttable presumption that an arrangement shall be presumed (unless proved to contrary by the assessee) to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit.
- This shows that some onus is still cast on the taxpayer to prove that arrangement is not entered into for main purpose of obtaining a tax benefit.
- In light of the above and to remove any avoidable uncertainty, we recommend that an express clarification should be made in simple and lucid language that onus of establishing satisfaction with ingredient of main purpose as also the onus of establishing compliance with additional ingredients will be on the tax department.

4.18.6. GAAR in the light of BEPS

GAAR as they stand in their current form, leave a lot of uncertainty and doubt on their practical application due to their very wide import.

On the other hand, the overwhelming support for the Base Erosion and Profit Shifting ('BEPS') project of the Organization of Economic Cooperation and Development ('OECD') and the speed at which it has progressed is testament to the importance that globally governments are attaching to countering tax practices inspired by BEPS activities.

If we look at the two concepts together, namely the BEPS project and GAAR, their ultimate motive is the same. However, the actions set out under the BEPS project are specific and detailed, whereas the GAAR is an all-encompassing, anti-avoidance provision.

Implementation of BEPS Action Plans is already set into motion. For example, Action Plans like exchange of information, country by country reporting, equalisation levy have already been legislated and other Action Plans are likely to be implemented in coming years.

The BEPS Action Plans are poised to considerably restrict and control abusive cross border tax practices. Accordingly, it is desirable that any further action in India is co-ordinated with the BEPS actions instead of multiplying legislations.

Further, it may also be recommended that GAAR should not apply to a transaction/ arrangement where the same is otherwise covered under the BEPS Action Plan/s.

4.18.7. Appeal against directions of Approving Panel

Section 144BA provides that the directions, issued by the Approving Panel shall be binding on the taxpayer and the Commissioner, and no appeal under the Act shall lie against such directions. In the absence of any right to appeal under the Act, the taxpayer will only have an option to file a writ to challenge the directions of the Approving Panel.

The provisions need to be amended to state that the directions issued by the Approving Panel can be appealed with the Tribunal and higher forums.

Section 144BA(17) of the Act provides that the term of the Approving Panel shall ordinarily be for one year and may be extended from time to time up to a period of three years. This is unjustified as one cannot expect an Approving Panel to change every year and to do justice in one year. In fact, considering the complexities involved, the minimum term for such Approving Panel should be three years and it may be extendable up to five years.

4.18.8. Determination of Consequences of GAAR

- Section 98 of the Act deals with the determination of consequences in the event a transaction is held to be an 'impermissible avoidance arrangement'. Beyond providing an illustrative list of the various consequences that can ensue in this regard, the Act does not provide any further guidance in this regard.
- Considering the wide ranging powers given to the tax authorities to determine the consequences of impermissible avoidance arrangements, it is imperative that detailed and comprehensive guidance be issued to the tax authorities to ensure that in practice, the consequences of a transaction being treated as an 'impermissible avoidance arrangement' are determined in a uniform, fair and rational basis.
- The determination of consequences is relatively simpler in cases where the transaction characterized as an 'impermissible avoidance arrangement' is a nullity with no commercial or economic implications to the parties involved, other than the saving of taxes. In such cases, the consequences should merely be to deny the tax benefit availed. However, in instances where the transaction results in a change in the economic rights and obligations of the parties, the consequences determined by the tax authorities should take into account the changed economic relationship. In other words, the consequences should be designed to achieve the same commercial result, with the only difference being that the tax benefit is denied. Further, the tax consequences should not be determined by recharacterising a transaction in a manner that is commercially and economically implausible.
- Section 98 of the Act also talks about reallocating expenses, receipts etc. between parties to an arrangement. Compensating adjustments are thus clearly contemplated under the Act. There is a general lack of familiarity in India about compensating adjustments considering that such adjustments are not permitted under Indian transfer pricing rules. As a result, detailed guidelines in this regard may be required to ensure that such compensating adjustments are done in a consistent and fair manner.

4.18.9. Other Points

- Threshold for invocation of GAAR: As per Rule 10U of the Income Tax Rules, 1962 ('the Rules'), the provisions of GAAR do not apply to an arrangement where the tax benefit arising to all the parties to the arrangement in the relevant AY (AY) does not exceed Rs. 3 crore in aggregate.

  There is no clarity on how a participant in the arrangement will know the quantum of tax benefit arising to a co-participant, especially in a situation where there are many participants which in general do not share the information of benefit arising out an arrangement.

  We further understand that the tax benefit is to be considered on a gross basis for computing the threshold for the applicability of the GAAR. Currently, the law as it stands, nowhere clearly states whether the tax benefit mentioned above includes any loss or a cost or a corresponding impact in the hands of other parties to the arrangement. Accordingly, it is not clear whether in determining the aggregate threshold of INR 3 crores, the quantum is to be determined on a 'gross' or 'net' basis.

  GAAR is to apply to all the parties to the arrangement. Thus, the tax impact of INR 3 crores should be considered after taking into account impact to all the parties to the arrangement i.e.; on a net basis and not on a gross basis (i.e.; impact in the hands of one or few parties selectively).

  In any event, it is submitted that the limit of Rs. 3 crores is too low, given the nature of GAAR. In order to ensure that the invocation of GAAR is restricted to cases of large-scale tax avoidance, it is submitted that the monetary threshold be significantly increased- at least to Rs. 10 crores.

  Further clarity should be provided as to how the limit of Rs. 3 crores has to be determined.

- Negative list: A distinction between tax mitigation and tax avoidance should be made to ensure that legitimate business choices do not result in the invocation of GAAR. To ensure clarity, as recommended by the Shome Committee, an illustrative negative list of such instances where GAAR cannot be invoked should be issued.

  Withholding tax certificate: Currently, there is no clarity on the applicability of GAAR provisions at the time of disposal of the withholding tax application under section 195(2) (i.e. withholding tax application by payer) or 197 (i.e. withholding tax application by payee) of the Act. Invoking GAAR at such stage would impose a heavy cash flow burden on the parties and would also unnecessarily add to the cost of doing business in India.

  The current viewpoint of the Expert Committee provides that it would be sufficient if the taxpayer (i.e. payer of the income to the payee) submits an undertaking to pay tax along with interest, in case in due course of assessment it is established that GAAR provisions are applicable in relation to the remittance/payments.

  In this connection, it is submitted that there could be cases where, despite reasonable care and diligence, it may not be possible for a tax deductor to visualize the possibility of GAAR being invoked in the case of recipient. The objective of GAAR is to bring under the net those who gain tax benefit by an abuse of the law provisions. The tax deductor normally does not secure any tax benefit as he is only responsible for making payment of TDS to Government and make remittance to the recipient of income.

  Hence, it would be harsh to expect a tax deductor to anticipate risk of a transaction being subject to GAAR and bear the burden of tax which is rightfully payable by the recipient of income. Further, an undertaking would unduly put a tax deductor at substantial risk.

  It is hereby recommended that the proposed guidelines should clearly state that the provisions of GAAR should not be invoked at the time of disposal of withholding tax application either under section 195/197 of the Act.

- Examples: Considering the subjectivity inherent in the language employed in the GAAR, comprehensive examples must be provided in the Guidelines in respect of each category of transactions that could be considered as ‘impermissible avoidance arrangements’ i.e. which create rights and obligations that are not normally created between persons acting at arm’s length, misuse or abuse of the provisions of the Act, which lacks commercial substance, or which is not bona fide. These will bring in some element of objectivity in the application of GAAR as well as provide taxpayers with valuable guidance as to what would be considered ‘impermissible avoidance arrangements’ under GAAR.

  The guidelines on GAAR should provide more clarity and examples on certain terms, such as ‘tax mitigation’, ‘tax avoidance’, ‘misuse or abuse’, ‘lacks commercial substance’, ‘significant’, ‘bona fide purpose’, ‘a step of the arrangement or part of the arrangement’ etc., as these are very subjective.

- General Rulings: The Finance Act, 2012 specifically permitted a taxpayer to make an application to the Authority for Advance Rulings (AAR) for a determination as to whether a proposed arrangement is an ‘impermissible avoidance arrangement’. While this is a welcome step, considering the backlog of pending matters with the AAR, it may be useful if the Approving Panel can additionally provide/ issue ‘General Rulings’ on several common transactions setting out in detail the various parameters that must be met, if a transaction is to avoid being characterized as an ‘impermissible avoidance arrangement’. This may be done to supplement the examples given to illustrate various aspects of the GAAR.

- Annual Summary by Approving Panel: With a view to building up a body of guidance clarifying the applicability of the GAAR, the Guidelines should require the Approving Panel to summarise and publish a synopsis of each case dealt with by the Approving Panel (duly summarized and anonymised to preserve taxpayer confidentiality) on an annual basis.

- Law Officers: As stated above, the Commissioner should be required to independently review the legal and factual basis of invocation of the GAAR and to specifically address the issue of whether the invocation of GAAR in a particular case would stand up to judicial scrutiny. In arriving at this conclusion, the Commissioner must be required to refer the case to appropriate law officers of the Government of India (i.e. the Additional Solicitor General of the jurisdictional High Court) to ascertain his/her views as to the legal basis for invocation of GAAR.
- Periodic Review: In order to assess the broader impact of GAAR on the overall economic and investment climate and to evaluate its working, an expert committee comprising of independent members should be set up after 3 years to review the overall working of the GAAR in India and make recommendations as to (i) whether it should be retained (ii) whether any systemic changes in the law / departmental guidelines need to be made to ensure its smoother working.

4.18.10. Rationalization of GAAR – Other Recommendations

i. Corresponding/Correlative adjustments

Provisions for avoiding tax of same income in the hands of a assessee across tax years and the taxation in the hands of the counter party, if the GAAR provisions are applicable is currently missing in the GAAR.

As per the recommendations of the Expert Committee, while determining tax consequences of an impermissible avoidance arrangement, corresponding adjustment should be allowed in the case of the same taxpayer in the same year as well as in different years, if any.

It is advisable that where any arrangement is disregarded in full or part, (apart from recommendation that corresponding adjustment be allowed to the same taxpayer) consequential relief in the form of correlative adjustment should also be provided to other party/parties of the arrangement so that there is no double taxation of same income.

ii. Reporting Requirement

As per the final report of the Expert Committee, it is recommended that the tax audit report may be amended to include reporting of transactions above specific threshold (i.e.; INR 3 crores) which are considered as an impermissible avoidance arrangement under the Act.

However, determining the applicability of the provisions of the GAAR would be an onerous task for an auditor as it would not be possible for a professional to certify the same. The applicability of GAAR is otherwise a subject matter of determination through a series of steps involving the tax authority, Commissioner, Approving Panel, etc.

Accordingly, it is recommended that the disclosure requirement (as recommended by the Expert Committee) in the Tax audit report be dropped.

iii. Internal Reorganizations

The internal reorganizations that do not give rise to any profits from the third party and restructurings done for regulatory, commercial or efficiency reasons should be made outside the ambit of GAAR.

4.19. Tax Incentives and Benefits -¬ Section 35AD

4.19.1. Dilution of Tax Incentive under Section 35AD by insertion of Section 73A of the Act

Issue

- The underlying idea behind allowing the investment linked incentive granted under Section 35AD of the Act is to enable the taxpayer to set-off the business losses incurred by this write-off against the taxable profits from

their existing businesses and reduce their tax liability in the year of deduction and thereby to provide part of the resources of investment required for setting up of the businesses. However, the incentive so intended cannot be achieved owing to Section 73A of the Act, which restricts the set-off/ carry forward of losses by specified business only against the profits and gains, if any, of any other specified business carried on by the taxpayer in that AY and the amount of loss not so set-off can only be carried forward and set-off against profits from specified business in the subsequent AYs.

Recommendation

- The losses from the specified business under Section 35AD of the Act ought to be made eligible for set-off against profits from other businesses of the taxpayer, and not restricted to be set-off against only the specified businesses, as it is not always the case that the taxpayer would only be carrying on the 'specified business'. In light of the above, section 73A of the Act should therefore be deleted.

4.19.2. Clarification on Amendment to Section 35AD(3) of the Act

Issues

- The amendment to Section 35AD(3) of the Act carried by the Finance Act, 2010, seeks to prevent a taxpayer from claiming dual deduction in respect of the same business.
- It appears that if a taxpayer carrying on a specified business does not claim deduction under section 35AD, he may opt for deduction under the relevant provisions of Chapter VI-A or Section 10AA, if the same exist for such business and it is more beneficial.

Recommendations

- A clarification should be issued that the taxpayer may exercise an option (where available to the taxpayer) to avail tax incentive under section 35AD or Chapter VI-A/ Section 10AA of the Act, depending upon which is more beneficial to the taxpayer.
- Further, it is suggested that a clarification may also be issued that in the event the taxpayer opts for the investment linked incentive under Section 35AD of the Act and the same is denied/rejected at time of assessment proceedings (could be on account of non-satisfaction of prescribed conditions), in such case the taxpayer is eligible to make an alternative claim under Chapter VI-A or Section 10AA, on satisfaction of the conditions provided therein, notwithstanding the requirement stipulated in Section 80A (5) of the Act or 10AA of the Act. This is because, a taxpayer who is otherwise entitled to deduction in respect of qualifying profits of the specified business would lose such deduction on account of Section 80A(5) of the Act that mandates a claim for deduction under chapter VI-A be made in its return of income. As the taxpayer would not have claimed deduction under provisions of Chapter VI-A/ Section 10AA of the Act in its return of income since claim was made under Section 35AD of the Act, such taxpayer would be precluded from claiming deduction in view of Section 80-A(5)/ Section 10AA of the Act.

4.19.3. Investment Linked Tax Incentive under Section 35AD is a Restrictive Tax Incentive

Issues

- Section 35AD of the Act extended investment linked tax incentive to a taxpayer engaged in building and operating anywhere in India a 2-star or above category hotel. The same is a restrictive tax incentive to the industry as only such taxpayers are eligible which are engaged in both building and operating the hotel. Similar restriction exists for the hospitals, wherein the tax incentive is available for 'building and operating' anywhere in India a hospital with at least 100 beds for patients.'

- Thereafter, vide Finance Act, 2012 w.e.f. 1st April 2011, a new section 35AD(6A) of the Act was inserted, which extended investment linked tax incentive to a taxpayer engaged only in 'building' hotel (and transferring the operation to another person). However, similar benefit was not extended for taxpayer engaged in building hospital.
- As can be seen from a plain reading of Section 35AD of the Act, it appears that the benefit under the section would not be available in case the person building the hospital is different from the person operating it. This does not seem to be in harmony with the objective, specifically given the typical operating structure of the industry wherein very often the developer or builder of the hospital is different from the taxpayer who is operating and managing the hotel/hospital. Considering, the said anomaly was removed by the Finance Act, 2012, vide Section 35AD (6A) for hotel industry by granting investment incentive to a builder (though not operating the hotel), similar benefit ought to be extended to a hospital industry.
- Further, if a person does not build the hotel/hospital, but acquires the same by purchase or rent or otherwise for purposes of operation and management thereafter, such taxpayer would not be entitled to the benefits of this section.

Recommendations

- In view of the above discrepancy, a clarification is required and it is suggested that the relevant clause be amended to read as under:

> "(aa) on or after 1st day of April, 2010, where the specified business is in the nature of building or operating or building and operating a new hotel of two-star or above category as classified by the Central Government."

Similar amendment is also recommended for the hospital sector and the relevant clause be amended to read as under:

> "(ab) on or after 1st day of April 2010, where the specified business is in the nature of building or operating or building and operating a new hospital with at least one hundred beds for patients"

- Consequential amendments should also be considered in clause (iv) and (v) of sub-Section (8)(c)of Section 35AD of the Act.

4.19.4. Need for consequential Amendments due to Section 35AD(7B)

Issue

If any asset for which such deduction is allowed, is used for other than the specified business, before the period of eight years after the asset acquisition, then such deduction allowed, as reduced by the amount of depreciation allowable as if no deduction under this Section was allowed, shall be deemed to be the business income of the taxpayer of the FY in which the asset is so used. The period of eight years is very high and non-transferability of an asset for such a higher period puts restriction on the transfer of independence of the taxpayer's business decision and therefore, will prove to be counter-productive to the business growth. Further, there is no consequential amendment to section 43(1) or section 43(6) of the Act to enable the taxpayer to claim depreciation for subsequent years based on Written Down Value ('WDV') in the year of charge back under section 35AD(7B) of the Act. There is no amendment made to section 50B of the Act to allow inclusion of such WDV in the computation of 'net worth' of the undertaking. In absence of above referred consequential amendments, the taxpayer will be denied depreciation for subsequent years and would be also be taxed on higher capital gains on slump sale of undertaking.

Recommendations

- The condition of non-transferability of the asset should be reduced to at least four years since even usage of the asset for four years indicate that the taxpayer intended to use the asset for the specified business.
- It should be further clarified that if an asset is not used for the specified business due to obsolescence, etc. and at the same time not used in any other business, then the deduction allowed under this Section shall not be reversed.
- In case where benefit of deduction granted under section 35AD of the Act is taxed by invoking provisions contained in section 35AD(7B) of the Act, appropriate consequential amendment should be made to section 43(1) of the Act to give consequential effect to allow depreciation on such asset in subsequent years. For this, appropriate amendment should also be made in section 43(6) of the Act to treat such asset as part of relevant block of assets. Also, section 50B of the Act should be amended to include WDV of such asset in the 'net worth' computation.

4.19.5. Tax Incentives - Weighted Deduction under Section 35(2AB)

Issues

- Section 35(2AB) of the Act extends weighted deduction towards the expenditure incurred towards scientific research on in-house research and development facility as approved by the prescribed authority to companies engaged in the business of
  - bio-technology; or
  - manufacture or production of any article or thing (other than those specifically excluded for purposes of this tax incentive).
- The Finance Act, 2016, with a view to phase out weighted deduction under section 35(2AB) of the Act, restricted the allowability of expenditure incurred on scientific research (other than expenditure in the nature of cost of any land or building) on in-house research and development facility to 150% from 200% with effect from April 1, 2017 to March 31, 2020 and to 100% from previous year 2020-21 onwards. Withdrawal of weighted deduction in respect of scientific research expenditure will put a dent to the 'Make in India' initiative of the Government.
- The aforesaid Section extends the weighted deduction of expenditure incurred only in respect of "in-house research and development facility". India is globally recognised as an attractive jurisdiction for outsourcing owing to its affordable, skilled and English-speaking manpower. Outsourced R&D work is becoming a key area of growth for the Indian services sector however there are no specific tax benefits available to units engaged in the business of R&D or contract manufacturing. Such tax benefits are the need of the hour to foster the growth of R&D segment and help achieve the Hon'ble Prime Minister's vision to turn India into a manufacturing/research powerhouse.
- Further, specifically in the pharma sector, pharmaceutical discovery is a lengthy, risky and expensive proposition. In this business environment, necessitated by the current business needs, sometimes companies incur expenses towards scientific research outside their R&D facility.
- Another anomaly existing in the current provisions is that any expenditure incurred outside the approved R&D facility by pharma companies' i.e. towards clinical trials (including those carried out in approved hospitals and institutions by non-manufacturing firms), bioequivalence studies conducted in overseas CROs and regulatory and patent approvals, overseas trials, preparations of dossiers, consulting/ legal fees for filings in USA for new chemicals entities (NCE) and abbreviated new drug applications (ANDA) as approved by the Department of

Scientific and Industrial Research (DSIR) which are directly related to the R&D, etc. are currently not covered. Furthermore, Indian companies incur substantial costs in defending their patent rights and applications in and outside India and these sums are not eligible for deduction.

- The weighted deduction under section 35(2AB) of the Act is not available while computing book profits for the purpose of MAT provisions, which dilutes the benefit provided under section 35(2AB) of the Act as R&D in all sectors, especially biotech, pharma, etc. is very expensive and time consuming.

Recommendations

- It is suggested that weighted deduction @ 200% under section 35(2AB) of the Act be continued to promote research and development in the manufacturing space and to make India a manufacturing hub.
- It is suggested to extend tax benefits to units engaged in the business of R&D or contract manufacturing to provide impetus to R&D in India.
- Presently, there are no specific provisions which enable carry forward of R&D benefits separately. Considering the time taken in R&D activity, and its benefit available after a very long gap, it is suggested that it should be clarified that the unutilized R&D deduction should be available for carry forward and set off indefinitely (as in the case of unabsorbed depreciation).
- Benefits in the form of research tax credits which can be used to offset future tax liability, similar to those given in developed economies can also be introduced.
- It is further suggested that the existing provisions should specifically allow weighted deduction in respect of expenses incurred outside the R&D facility which are sometimes necessitated by the industry's business needs. Additionally, it could be clarified that where the risk of doing research is assumed by a company, the entire cost of R&D activities (whether outsourced or undertaken in-house) is eligible for weighted deduction in the hands of company undertaking the risk.
- It is recommended that weighted deduction of expenditure as per section 35(2AB) of the Act should also be allowed while computing book profits under Section 115JB of the Act.

Issues

- Currently, there seems to be an ambiguity with respect to whether a company engaged in the business of development and sale of software or providing IT services or ITES is eligible for weighted deduction on the R&D expenditure incurred by it.
- Currently, as per DSIR guidelines amount spent by a recognized in-house R&D towards foreign consultancy, building maintenance, foreign patent filing etc. are not eligible for weighted deduction under Section 35(2AB) of the Act. Such expenses are essential in carrying out research at the approved R&D centres.

Recommendations

- Explicit provisions should be introduced in the Act, to provide that DSIR can approve the R&D facilities of the companies engaged in development and sale of software. It is further recommended that weighted deduction for R &D expenditure be extended to service sector as well.
- It is further suggested that DSIR guidelines need to be modified accordingly to specifically include expenses (such as foreign consultancy, building maintenance, foreign patent filing etc.) for claiming weighted deduction under Section 35(2AB) of the Act.

Issue

- The DSIR guidelines provide that eligible capital expenditure on R&D will include expenditure on plant, equipment or any other tangible item only. It also provides that capital expenditure of intangible nature is not eligible for weighted deduction.

Recommendations

- It is recommended to provide weighted deduction for expenditure incurred on internally developed intangible assets under Section 35(2AB) of the Act.
- It is also recommended that any initial cost paid for acquiring R&D related intangible assets, which are used in the R&D unit should also be allowed for weighted deduction under Section 35(2AB) of the Act.

4.19.6. Tax Incentives for Rural/ Semi-urban Healthcare Infrastructure

Issue

- Currently, there are no benefits available under the Act for development of rural/semi-urban healthcare infrastructure.

Recommendation

- Rural and semi urban areas in India do not have basic healthcare infrastructure and the rural healthcare infrastructure needs to be augmented and strengthened. Further, setting up infrastructure in such areas involves substantial investments and a long gestation period. Accordingly, it is essential that tax incentives are made available to promote investments in such areas in keeping with Government's focus on improving affordable healthcare and to move towards 'Health for All'. It is recommended that weighted deduction for expenditure incurred in the rural/ semi urban areas for developing health care infrastructure should be provided.

4.19.7. Extension of Tax Holiday to Power Companies

Issue

- Power is the critical infrastructure on which the socio-economic development of any country depends. So a clear and stable tax regime is bare minimum requirement of the investors/developers engaged in development of power plants. Presently, companies engaged in development of power plants are eligible for deduction under section 80-IA of the Act. However, the same is set to expire on 31st March 2017.

Recommendation

- The Indian Government has time to time extended the eligibility period for generation of power for claiming tax holiday. Therefore, in the interest of investors, it is recommended that eligibility period should be extended from 31 March 2017 to say 31 March 2020, especially given the coal shortage and other problem being faced by the sector.

4.20. Carry Back of Losses - Section 72

Issue and Recommendation

- It is has been observed that provisions relating to carry-back of business losses are prevalent in many developed countries like United States of America, Singapore, United Kingdom etc. In case of carry back of losses, losses are allowed to be offset with the profits of the previous years.

  Such provisions should also be introduced in the Act and carry back of losses up to 3 to 5 years should be allowed.

4.21. Deduction under Section 80JJAA of the Act

Issues

- The Finance Act, 2016 has liberalised the conditions for allowability of deduction in respect of employment of new employees by amendments in section 80JJJAA of the Act. However, one of the conditions stipulated by the section is that an employee should be employed for a period of two hundred and forty days or more during the previous year of employment. In a situation, where an employee worked for less than 240 days in the relevant previous year of employment i.e. in Year 1 but for full year in Year 2 and Year 3 and assuming all other conditions prescribed in Section 80JJAA of the Act are complied with, the assesse is still not eligible to claim deduction in any of the years.
- It is not clear as to whether the deduction is in the nature of standard deduction whereby the quantum is ascertained with reference to additional wages paid in Year 1 and 30% thereon is allowed in Years 1 to 3 or is it linked to wages paid to qualifying workers in each of the years 1 to 3. There could be variation in the amount of deduction in Year 1, 2 and 3 based on wages paid to the same worker.

Recommendations

- It is recommended that amendment be made in section 80JJAA of the Act to provide that employees in respect of whom the period of continuous employment of 240 days or more is attained in the previous year succeeding the previous year in which he is employed, the deduction under section 80JJAA of the Act should be granted from the succeeding previous year.
- It may also be clarified that the deduction under section 80JJAA of the Act is in the nature of standard deduction for Years 1 to 3 based on additional wages paid in Year 1.

4.22. Ambiguity out of Recent Circulars, Notifications issued by CBDT

4.22.1. Applicability of CBDT Circular on Formation of AOP vis-à-vis the EPC Contracts

The term Association of Persons (AOP) has not been defined in the Act. As per Section 2(31) of the Act, 'person' includes association of persons or body of individuals, whether incorporated or not. Explanation to Section 2(31) of the Act further provides that an AOP shall be deemed to be a person, whether or not such person or body was formed or established or incorporated with the object of deriving income, profits or gains.

As per the above Explanation, if an AOP is formed for non-profit motive, then also it is deemed to be covered under the definition of a person. Therefore, meaning of "AOP" needs to be understood with the help of the various judicial precedents pronounced in this context which have taken divergent/contrary views in different cases and various dictionaries stating the plain ordinary meaning of the term on the basis of which the essential characteristics of an AOP can be derived.

Issue

A Large number of infrastructure contracts are awarded by Public Sector Undertakings/ Government companies to non-residents. Many developers also require contractors to bid in a consortium with a view to ensure that specific components of the project get executed by an earmarked contractor who has requisite capabilities in this regard and yet, derive the comfort that the entire project (comprising of several parts) would be successfully commissioned by the consortium of contractors, although each contractor will be executing its specific part only. The consortium members/ contractors undertake their respective scope of work separately/ independent of each other and do not share profits/ losses with each other. Further, there is a separate consideration earmarked for each contractor and the payment is made directly to respective contractor by the customer. Thus, contractors enter into consortium and agree to jointly

undertake the work for better co-operation in their relationship with the developer/ provide comfort to developer and for no other purpose.

The intention behind consortium/contract split arrangements is never to constitute a partnership/AOP but to meet the business requirements of the developer.

The tax authorities tax such non-residents as AOP at the withholding tax/assessment procedure stage on the basis of a few favourable AAR rulings. Further, there are tax complexities that are associated with assessments of AOP, including double taxation of non-residents in India and their country of residence (with no possibility of double taxation being avoided). The said position of the tax authorities is causing hardship to the industry and is also resulting in pessimism as regards the uncertain tax environment in India. Large amount of working capital is also getting blocked up in TDS/ payment of tax demands consequent to completion of assessments.

Thus, no clear definition pertaining to AOP in the Act leads to an ambiguity. Referring to the legal jurisprudence for understanding the meaning of term 'AOP' results in unwarranted litigation and subjectivity.

Recommendation

It is recommended that the term AOP may be appropriately defined by laying down definite features of an AOP in the Act which would help in providing certainty and help in reducing litigation for the consortium formed by non-residents to execute Engineering, Procurement and Construction ('EPC') and turnkey contracts in India. In this regard, it is suggested to insert an Explanation to Section 2(31) of the Act for encompassing inclusions and exclusions for an AOP so that there is more clarity as to what sort of arrangement among companies associating together for carrying out turnkey projects would give rise to an AOP.

4.22.2. CBDT Circular No. 7 of 2016, dated 7 March 2016

With a view to avoid tax disputes and to have consistency in approach, CBDT vide Circular No. 7 of 2016, dated 7 March 2016 has laid down certain attributes which would not lead to constitution of an AOP:

- Each member is independently responsible for executing its part of work through its own resources and also bears the risk of its scope of work i.e. there is a clear demarcation in the work and costs between the consortium members and each member incurs expenditure only in its specified area of work.
- Each member earns profit or incurs losses, based on performance of the contract falling strictly within its scope of work. However, consortium members may share contract price at gross level only to facilitate convenience in billing.
- The men and materials used for any area of work are under the risk and control of respective consortium members;
- The control and management of the consortium is not unified and common management is only for the inter-se co-ordination between the consortium members for administrative convenience.

  The above stated Circular has provided clarity to a certain extent. However, some of the issues emanating from the circular are as below:-

Issues

- The Circular states that it shall not apply where all or some of the members of the consortium are Associated Enterprises (AE) under Section 92A of the Act. In such cases the AO shall decide whether an AOP is formed or not, keeping in view the relevant provisions of the Act and judicial precedents on the issue. There does not appear to be any reason to exclude related parties from the purview of the above circular to determine the existence

of AOP or not. In fact, similar principles should also be applicable to determine the existence or otherwise of an AOP in situations where some of the parties to the consortium are related to each other.

- If the members of the consortium jointly indemnify the project owner with respect to the breach of performance of work scope of any of the consortium members, would this lead to existence of AOP?
- A clarification is required that if the money/consideration is credited to a common bank account of the consortium members post which it gets divided amongst the members - would this lead to creation of an AOP?

  It should be clarified that the emphasis should be placed on the terms agreed between the consortium members and not between the project owner and the members. The internal agreement between the consortium members discusses in detail about inter-se roles, responsibilities, risks etc. of the consortium members.

Recommendations

- It is recommended to provide clarity on the above issues concerning the formation of an AOP. This would help in plugging gaps that are still existing and bring larger clarity on the issue.
- It is suggested that the benefit of this Circular should also be extended to AE situations where such AEs are members of the consortium for executing EPC/turnkey contracts. It is recommended that definitive guidelines must be provided even in case of associated enterprises with adequate checks.

4.22.3. Notification No 53 dated 24 June 2016 (Relaxation in requirement to furnish PAN)

The CBDT vide Notification 53/2016 has notified new Rule 37BC which states that provisions of section 206AA (requiring deduction of tax at a higher rate) shall not apply on payments in the nature of interest, royalty, fees for technical services and payments on transfer of any capital asset provided the non-resident (deductee) furnishes following prescribed documents:-

- Address in the country or specified territory outside India of which the deductee is a resident;
- Name, e-mail id, contact number;
- A certificate of his being resident in any country or specified territory outside India from the Government of that country or specified territory if the law of that country or specified territory provides for issuance of such certificate;
- Tax Identification Number of the deductee in the country or specified territory of his residence and in case no such number is available, then a unique number on the basis of which the deductee is identified by the Government of that country or the specified territory of which he claims to be a resident.

While the above is a very welcome Notification which will obviate hardships caused by several non-residents who suffer withholding at a higher tax rate, the following should also be clarified:-

- Relaxation in requirement to furnish PAN should be made applicable on all types of payments and should not be restricted only to interest, royalty and fees for technical services.
- Also, in order to remove any potential ambiguity, it should be expressly clarified that treaty benefits will continue to be available even in absence of PAN provided the requisite documents as prescribed are furnished.
- There has been a fair bit of litigation surrounding the scope of section 206AA, especially in relation to its applicability to treaty countries. The Pune Tribunal decision in the case of DDIT vs Serum Institute of India Ltd. (68 SOT 254) which has held that where the tax has been deducted on the strength of the beneficial provisions of DTAAs, the provisions of section 206AA of the Act cannot be invoked by the Assessing Officer to insist on the tax deduction @ 20%, having regard to the overriding nature of the provisions of section 90(2) of the Act.

Similar, is the view of Bangalore Tribunal decision in the case of **DDIT vs Infosys BPO Ltd. (154 ITD 816)**. Thus, as a positive gesture and in order to allay any unintended litigation, it should be expressly clarified that treaty benefits will continue to be available even in absence of PAN provided the requisite documents as prescribed are furnished.

- Further, in order to avoid such protracted litigation, the relaxation granted vide this notification should also apply to pending assessments and appeals provided the requisite documents as mentioned in the Notification are furnished.

4.22.4. Office Memorandum dated 29 February 2016 (Guidelines for Stay of Demand)

CBDT has modified Instruction No 1914 to provide that in a case where demand is disputed before the CIT(A)/ first appeal stage, the AO shall grant stay of demand till disposal of first appeal on payment of 15% of disputed demand.

In order to remove any potential ambiguity, the following points warrant consideration:-

- It should be clarified that the aforesaid relaxation should also be applicable if appeal is pending before the ITAT for taxpayers who have opted for the Dispute Resolution Panel (DRP) route (as for such taxpayers, ITAT is their first appellate authority).
- Further, in case of matters which are already covered in the favour of assessee (by virtue of favorable Tribunal or High Court orders), it should be clarified that:
  - Such demand should not be adjusted under section 245 against refunds of any other years.

    Such proposition is upheld by the Bombay High Court in the case of HDFC Bank Ltd. (**354 ITR 77**). The relevant extracts are reproduced below:-

    "… The adjustment of a refund is a mode of effecting recovery. ***Once an issue has been covered in favour of the assessee in respect of another assessment year on the same point, it was wholly arbitrary on the part of the department to proceed to make an adjustment of the refund. If the adjustment was not made, there can be no manner of doubt that the assessee would have been entitled to a stay on the recovery of the demand.*** *The demand cannot be adjusted by the department in this manner merely because it is in possession of the funds belonging to the assessee to which the assessee is legitimately entitled to and has been granted a refund. The making of an adjustment in these facts is totally arbitrary and contrary to law."*

The Delhi High Court ruling in the case of Maruti Suzuki India Limited vs. DCIT (**347 ITR 43**) also hold a similar view. Relevant extracts reproduced below:-

"In view of the findings recorded above, we have no hesitation in holding that ***conduct and action of the respondent-Revenue in recovering the disputed tax in respect of additions to the extent of Rs.96 crores on issues which are already covered against them by the earlier orders of the ITAT or CIT (Appeals) is unjustified and contrary to law. Accordingly, directions are issued to the respondents to refund Rs.30 crores, which will be approximately the tax due on Rs.96 crores.*** *The said refund shall be made within one month from the date when a copy of this order is made available to the respondents…".*

  - Merely because the tax department has filed an SLP before the Supreme Court should also not be a ground for not allowing the stay of demand (in cases where issues are already covered in favour of taxpayer by High Court orders).
  - Alternatively, AO should grant stay of demand till disposal of appeal on payment of 5% or 10% of the disputed demand.

The above clarifications will certainly provide a much needed relief to the taxpayers.

4.22.5. Characterisation of Income from Transfer of Unlisted Shares

With a view to having a consistent view in assessments pertaining to income from transfer of unlisted shares, the CBDT has clarified that the income arising from transfer of unlisted shares would be considered under the head 'Capital Gain', irrespective of period of holding, with a view to avoid disputes/litigation and to maintain uniform approach.

However, this letter provides that this principle would not necessarily apply in situations where the transfer of unlisted shares is made along with the control and management of underlying business. It is provided that the Assessing Officer would take appropriate view in such situations. This leads to significant uncertainty as the change to the control and management is a direct result of the transfer of shares, and is often referred to in share purchase agreements to avoid contractual disputes and to ensure continuity of business. This should ideally have no bearing on the characterisation of income from sale of shares.

Given the above, our recommendations are as under:-

- Transfer of control and management has no direct bearing on the characterisation of income from the transfer of shares. It is therefore necessary to address this anomaly and it should be provided that even in cases where transfer of shares results in transfer of control and management of underlying business, gains arising therefrom should be assessed under the head 'Capital Gains'.

  Also, it is pertinent to note that the definition of "capital asset" specifically includes management and control rights qua an Indian company. Accordingly, the purpose of this carve out is unclear as no basis is given for such an exclusion and could lead to unnecessary litigation.

- Further, the current Circular deals only with sale of unlisted shares and the same should be extended to all unlisted securities such as debentures and bonds of public and private limited companies.

- Also, similar to earlier Circular dated 29 February 2016 which was issued in the context of listed securities, an option should be provided to the assessee to treat the income as business income in case where shares of unlisted companies are held as stock in trade on a consistent basis.

4.22.6. Circular No. 4/2016 dated 29 February 2016

- In this Circular, the CBDT has clarified that where a consideration is payable towards a contract for production of content for a broadcaster/ telecaster (where rights in such content are also transferred to the broadcaster/ telecaster); such a contract is covered by the definition of 'work' as per section 194C of the Income Tax Act, 1961.

  However, it should additionally be clarified that in a case where 'funding' is provided by the broadcaster to the production house for production of content, no TDS obligation should arise on the broadcaster provided the amount of 'funding' represents a pure "reimbursement" of cost (without any mark-up) on which appropriate tax withholding is already done by the production house.

4.23. Non-Resident related provisions

4.23.1. Clarity on attribution of Profits to Permanent Establishment ('PE')

Issues

- PEs are alleged on account of mere procurement of orders for sale of goods or provision of services or answering sales related queries, etc. These are routine services outsourced to Indian enterprises;
- Provision of these services is the backbone of IT/ITeS sector in India for which they get remunerated at ALP.
- Foreign investors/companies are losing interest to invest in India since there is a tendency of the tax authorities

to allege that the Indian entity is a PE of the foreign entity. There is also unwarranted attribution of profits of the foreign entity to such an alleged PE. This is in-spite of the fact that Indian entity is remunerated at ALP by the foreign company and such ALP is accepted during transfer pricing audit of the Indian entity.

- Ad-hoc profit attribution is generally resorted to by the revenue authorities. The current rules for profit attribution (Rule 10) are not detailed and are inadequate to keep pace with the diverse approaches through which the non-residents carry on business in India. This has led to inconsistency in methodology followed by various tax officers while computing the amount of profit which can be attributed to a PE in India and thus adding to significant litigation.

Recommendations

- The law should categorically clarify based on SC decision in case of Morgan Stanley & Co Inc (292 ITR 416), wherein it has been held that no further profits can be attributed to PE, if PE is remunerated on arm's length basis taking into account all the risk-taking functions of the multinational enterprise. This will provide much needed certainty and reduce needless litigation.
- Also, it may be clarified that, in the cases of technologically intensive products, wherein risk/sale function etc. is primarily performed outside India, no profits may be attributed to India.

4.23.2. Clarity on Taxability of Offshore Supplies

Supply of heavy machinery and equipment from outside India in capital intensive/infrastructure companies is quite common. It includes supply of equipment, machines, tools, material etc. by a contractor from overseas. In case of offshore supplies, transfer of title in the goods generally happens outside India and the consideration for such supplies is also received by the non-resident contractor outside of India.

There has been significant controversy around taxability of offshore supplies where such supplies constitute part of a composite contract including onshore supplies and services. The tax authorities in such contracts allege that since offshore supply is part of the composite turnkey contract, income from such supplies should also be taxable in India.

Issue

Considering the definition/meaning of offshore supplies is not provided in the statute, the term is subject to wide and varied interpretation. Judicial precedents (including the Supreme Court) on this issue have time and again laid down the criteria to be satisfied for a supply contract to be considered as offshore and held that offshore supply is not liable to tax India. Even then the tax officers continue to hold that offshore supplies are taxable in India. This leads to prolonged litigation with the tax authorities since the matter largely gets settled at the tax Tribunal/Court level.

Recommendation

It is suggested that the Government should issue guidelines in relation to taxability of offshore supplies so that the essential aspects for taxing or making the same non-taxable are clearly spelt out. The Government may consider re-introducing Circular No. 23 dated July 23, 1969 with suitable modifications. This would provide greater level of certainty and help to reduce litigation for the non-resident contractors in India.

4.23.3. Clarification of the Terms 'Transfer of Title, Risk and Reward'

With changing times, the contracting terms between the parties have evolved significantly. For instance – a contracting structure could exist wherein the offshore supplies are required to be delivered on CIF basis to the Indian customer, even though the transfer of title in such goods happens outside India. Further, there are situations wherein the transfer of risk associated with the supply of goods happens in India, even though the transfer of title in such goods happens outside India.

In the above situations, where one of the events (such as transfer of risk) or some of the ancillary activities such as (inland freight, transportation etc.) happens in India, then the tax authorities hold that the transfer of title in the goods has not happened outside India. In these situations, the authorities tax the entire offshore supplies in India.

Recommendation

It is recommended that clear guidelines keeping the practical aspects should be laid out in relation to transfer of title, risk and reward.

4.23.4. Clarity on Applicability of Presumptive Taxation Regime – Section 44BB

Issues

- Under section 44BB of the Act, non-resident services providers to extraction or production of oil sector have an option to be taxed at a gross rate of 10 percent of receipts on presumptive basis.
- Amendment was introduced in 2010, wherein provisions of section 44BB will not be applicable where provision of section 44DA of the Act is applicable. This has resulted in ambiguity regarding applicability of provisions of section 44BB to non-residents providing services that are technical in nature to an Indian concern.
- This has challenged the settled tax position and resulted in tax litigation. Tax authorities have applied this amendment across all services in connection with exploration/production of oil & gas, by arguing that such services involve usage of technical knowledge and hence provisions of section 44BB of the Act are not applicable.
- It is a well-established fact that in a capital intensive and specialized industry like Oil & Gas, most services are embedded with a degree of skill/ technical function. The intention of the law makers to introduce section 44BB was primarily only to streamline the administrative burden on foreign companies engaged in the said sector and provide for a specific regime for such specialized service providers.
- Further, recently in the case of Oil & Natural Gas Corporation, who was assessed in a representative capacity on behalf of different foreign companies including Former France, the Supreme Court has held that any services rendered which is directly associated or inextricably connected with prospecting, extraction or production of mineral oil should be covered within the provisions of section 44BB of the Act.

Recommendation

- It should be clarified that presumptive taxation regime under section 44BB of the Act is applicable to non-residents for services rendered in connection with prospecting for, or extraction or production of mineral oils even if the same are technical in nature.

4.23.5. Concessional Tax Rate of 5% on Rupee Denominated Bonds (RDBs) (‘Masala Bonds’)

Issue

- CBDT vide press release dated 29 October 2015 has clarified that TDS rate on Off-shore Rupee Denominated Bonds (RDBs) shall be 5%, however, there is no legislative amendment to this effect. The existing section 194LC of the Act requires borrowing in foreign currency whereas existing section 194LD of the Act grants benefits on RDBs to a Foreign Institutional Investor (‘FIIs’) or Qualified Foreign Investor (‘QFI’) registered with SEBI alone while subscribers to off-shore RDBs will be larger body of non-residents not registered with SEBI.

  There is no other provision which grants concessional rate of 5% on such off-shore RDBs.

  Further, there is no clarity whether transfer of such RDBs through stock exchanges outside India will trigger capital gains in India. There could be litigation if the RDBs are regarded as having situs in India and hence, liable to capital gains in India.

- The concessional rate of withholding tax on interest as per section 194LC of the Act is applicable only in respect of monies borrowed under a loan agreement or by issue of long term bond (including long term infrastructure bond) before July 1, 2017. Since, the RBI has allowed the borrowing of money on rupee denominated bonds only with effect from September 2015, it is requested that the sunset clause under section 194LC of the Act may be extended by at least three years to effectively meet the funding requirements of Indian companies.

Recommendations

- It is recommended that pursuant to aforesaid CBDT Press Release, suitable amendment be made in the Act to provide for 5% rate on off-shore RDBs.
- Specific amendment on lines of section 47(viia) of the Act (ADR/ GDR) should be made to exempt transfer of RDBs on foreign stock exchanges from capital gains in India.
- It is recommended that the sunset clause under section 194LC of the Act may be extended by at least three years to effectively meet the funding requirements of Indian companies.

4.23.6. Provisions regarding Indirect Transfer of Capital Asset situated in India

Explanation 5 to Section 9(1)(i) of the Act, which was introduced by the Finance Act, 2012 provides that a share or an interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India, if the share or interest derives its value substantially from the assets located in India.

The Finance Act, 2015 has amended provisions dealing with indirect transfer of capital asset situated in India. The amendment provides clarity on certain contentious aspects with regards to taxation of income arising or accruing from such indirect transfers. Further, CBDT vide Notification 55/2016 dated June 28, 2016 has notified the Rules prescribing the manner of computation of FMV of assets of the foreign company or entity and relating to the reporting requirements by the Indian concern.

Issues and Recommendations

- As per section 285A of the Act, the Indian entity is required to furnish information relating to indirect transfers. In case of any failure, the Indian company will be liable for a penalty of INR 500,000 or 2% of the value of the transaction as specified.

  Considering the exhaustive list of information and documentation along with penal consequences for default (as envisaged in section 271GA), it is extremely onerous obligation on the Indian concern and it is farfetched that the Indian concern will be able to collate all such information.

  There are a large number of Indian companies that have raised capital from funds that invest in Indian companies through layers of investment holding entities. On grounds of confidentiality, the information on the investment holding entities and group entities is unlikely to be placed at the disposal of the Indian concern.

- It is recommended that the flexibility to comply with the reporting obligation under Rule 114DB be provided i.e. the reporting obligation should be complied either by the Indian concern or the transferor or transferee where the transfer of share/interest in the foreign company/entity is covered by provisions of section 9(1)(i) of the Act. As next best alternative, reporting obligation must be limited to a case where the transaction results in change in control and management of Indian company.

  Also, the Finance Act, 2015, prescribes a threshold for applicability for the indirect transfer provisions. There should also be a minimum threshold prescribed for reporting of transactions by the Indian entity.

- Provide a simple reporting obligation which shall comprise of base information such as details of transferor, transferee, subject matter of transfer and its valuation (similar to practice followed by Peru and Chile).
- The obligation of Indian concern should be restricted to the extent such Indian concern is possessed of information and/or documents. There should be no penal consequences in the event of failure to report, except when there is a misrepresentation.
- The Indian concern may be obligated to furnish information only in a case where the transfer is liable to tax under section 9(1)(i) of the Act. It may be explicitly provided that if the transferor is entitled to small shareholders exemption or avails treaty exemption or if transfer is exempt in terms of section 47 of the Act; there may be no corresponding obligation on the Indian concern as the transfer would not attract to tax under section 9(1)(i) of the Act.
- The expression "*Indian concern*" may have different meanings. It may even encompass permanent establishment or other forms of permanent establishments of a foreign company. Clarity needs to be provided on this aspect also.
- There is no clarity on the phrase 'assets located in India' mentioned in Explanation 5 to Section 9(1)(i) of the Act, given that the following interpretations are possible:-
  - Whether the section refers to shares of an Indian company as assets located in India; or
  - Whether it is referring to the assets owned and held by the Indian company whether in India or outside India.

Clarification should be provided for the phrase 'assets located in India' mentioned in Explanation 5 to Section 9(1)(i) of the Act.

- The intent of the law is to capture this gain if it is enclosed within an indirect transfer (instead of a direct transfer) and the India asset value is substantial at more than 50%. For this comparison, the fair value of the subject matter of indirect transfer should also be determined after taking liabilities into account. The commercial deal is unlikely to ignore the liabilities.
- Given its language, Explanation 6 to section 9(1)(i) of the Act is prone to serious tax litigation on its interpretation. Ignoring liabilities can lead to distortion of values - Explanation 6 to section 9(1)(i) of the Act, as proposed, requires that the fair value should be determined without reducing the liabilities. It is submitted that ignoring liabilities which are incurred in the conduct of business may distort the comparison of values substantially.
- Since the objective of the amendment is to tax indirect transfer through shell companies, a listed company should not be considered as a shell or conduit company. The same was also suggested by the Shome Committee.

  The non-exclusion of listed company shares from the ambit of the indirect transfer provisions will cause serious hardship to shareholders in several listed companies as well as pose several computational and practical challenges in cases where frequent trading of shares takes place on a daily basis.

  Such cases also pose significant challenges from the point of view of withholding, given that the very identify of the seller is not ascertainable. Further challenges exist in respect of ascertaining whether the seller holds more than 5% or not, whether he qualifies for treaty benefits, his cost of acquisition etc.

  Even if one were to take the view that withholding is merely a tentative determination of tax, and is subject to the correct determination at the time of assessment, the practical challenges in requiring millions of investors in stock markets around the world to obtain a TAN in India, deduct tax, and deposit the same with the government, and issue TDS certificates without even knowing the identity of the person on whose behalf such tax is deposited

are simply mind-boggling. Further, there would be no basis on which such buyers could even issue TDS certificates since the identity of the seller would not be known.

In view of the above, indirect transfer provisions must be suitably modified to provide for an additional exclusion from capital gains liability in cases of transfer of shares of foreign companies which are listed and regularly traded on recognized stock exchanges abroad. The criteria for recognition of stock exchanges and for determination of the regularly trading threshold may also be suitably clarified.

If this approach is not considered feasible, the following two proposals may be considered as an alternative:-

(i) A limited exclusion for transfers that take place on the stock exchange (as opposed to blanket exclusion for all listed shares). Such a provision will be similar to the domestic law exemption under Section 10(38) for transactions taking place on the stock exchange.

(ii) Exclusion from withholding in respect of all transactions in respect of listed securities. Given that there are serious practical challenges set out above on the withholding aspects, this could provide much needed relief.

- There are no provisions in the Act which exempts the Participatory-Note (P-Note) holders from the applicability of the provisions of indirect transfer on sale of P-Notes outside India.

  Therefore, it is recommended that the provisions should be made in the Act so as to explicitly exempt the P-Note holders from the applicability of the provisions of indirect transfer so as to provide certainty to Foreign Institutional Investors (FII) (who pay taxes in India on their income earned/derived in India) to encourage more foreign investments in India.

- Intra-group transfers as part of group re-organizations (other than amalgamation and demerger) should also be exempt from the indirect transfer provisions.

- While Explanation 5 to Section 9(1)(i) of the Act provides that shares of a foreign company which derives directly or indirectly its substantial value from the assets located in India shall be deemed to be situated in India. Section 47(vicc) provides exemption only if the shares of foreign company derive substantial value from shares of an Indian company. While the intent may be to exempt all cases of demerger where foreign company derives substantial value from assets located in India, the reading of Section 47(vicc) indicates that the said exemption would be available only in cases where the shares of the foreign company derive substantial value from shares of Indian company. Due to this inconsistency in the language of Section 47(vicc) vis-à-vis Explanation 5 to Section 9(1)(i), transfer of shares of a foreign company which derives its value predominantly from assets located in India (other than shares of an Indian company) under a scheme of demerger may be deprived of the aforesaid exemption. Similar inconsistencies also exit in the language of section 47(viab) of the Act.

  It is recommended that Section 47(vicc) should be amended to provide that *"any transfer in a demerger, of a capital asset, being a share of a foreign company, referred to in Explanation 5 to clause (i) of sub-section (1) of section 9, which derives, directly or indirectly, its value substantially from the* ***assets located in India****, held by the demerged foreign company to the resulting foreign company, if,—………………."* Similar amendment should also be made in Section 47(viab) of the Act (i.e. in case of amalgamation).

- In the context of amalgamations and demergers, section Act 47 of the Act provides for exclusion from capital gains tax subject to certain conditions. However, these exclusions are proving inadequate, with increased cross border economic activity and transactions.

For instance, although specific exemptions are provided for under section 47 for companies which are amalgamated/demerged in an offshore transaction that gives rise to indirect transfer tax in India, no corresponding exemption has been provided to the shareholders of such companies. This may be contrasted with the position in respect of domestic amalgamations/demergers where exclusion is provided in section 47 at both the company and the shareholder level.

Similarly, no exemption is provided for Indian shareholders owning shares in foreign companies which undergo an amalgamation/demerger.

Given the above, it is recommended that a specific provision along the lines of section 47(vii) of the Act may be inserted to protect shareholders of foreign amalgamating/demerged company. These must be provided for in the Act at the earliest.

4.23.7. Tax Neutrality in case of Overseas Reorganization

Issues

- The provisions of the Act are framed to provide tax neutrality only in cases where the amalgamated company is an Indian company. Section 47(vii) of the Act provides that a transfer of shares by the shareholder of an amalgamating company would not be liable to capital gains tax subject to the following conditions:-
  - The transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company, and
  - The amalgamated company is an Indian company.
- Clearly, the above exemption would be allowed only in case a foreign company is merged into an Indian company and not vice-versa. In other words, if an Indian company merges into a foreign company and the payment of consideration to the shareholders of the merging company is in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as envisaged in Section 234 of the Companies Act, 2013, the amalgamating company and its shareholders would be subject to capital gains tax in India.
- In the emerging global scenario it is important that the merger of Indian companies into foreign companies should be legally recognised and made pari-passu with the merger of foreign companies into Indian companies, particularly for income tax purposes.

Recommendation

- It is suggested that the requirement of transferee company to be an Indian Company under Section 47(vi) and (vii) of the Act should be removed.

4.23.8. Review of Retrospective Amendments made by Finance Act, 2012

(a) Clarification on Definition of Software Royalty – Section 9(1)(vi)

In Section 9(1)(vi) of the Act, Explanation 4 has been inserted with effect from the 1 June 1976, clarifying that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Royalty internationally applies to payments for use of a copyright, patent, trademark or such intellectual property. As per international commentaries and jurisprudence, any payments for use of a copyrighted article would not typically get covered under the term 'Royalty'. The Government should consider the adversity of the amendments made by Finance Act, 2012 on the businesses and make changes in the law to reverse its effect.

It is suggested to roll back Explanation 4 to Section 9(1)(vi) of the Act. Further, it is suggested that in view of the international tax practices and keeping in mind the impact on Indian industry, it should be clarified that the payments for use of copyrighted software made to non-residents would not be covered under the definition of 'royalty'.

Alternatively, the amendment should have only prospective application.

(b) Clarification on Inclusion of Explanation 5 to Section 9(1)(vi) of the Act

In Section 9(1)(vi) of the Act, Explanation 5 has been inserted clarifying that royalty includes and has always included consideration in respect of any right, property or information, whether or not:-

(a) the possession or control of such right, property or information is with the payer;

(b) such right, property or information is used directly by the payer;

(c) the location of such right, property or information is in India.

Issues

- Explanation 5 conflicts with the existing Explanation 2 to Section 9(1)(vi) of the Act in as much as there cannot be any transfer, right to use or imparting without the possession or control in the right, property or information vesting with the buyer/ payer. Explanation 5 also has the effect of taxing the consideration as royalty even if there is no transfer, right to use or imparting of any right, property or information to the payer.
- The provisions of this explanation are also not in line with the internationally accepted principles.
- By virtue of the above amendment, the scope of the term Royalty gets expanded to cover payments which are not intended to be covered. The mere fact that a transaction involves use of equipment by a service provider, without the customer having control/ physical possession of such equipment, payment for such facility/ services cannot be treated as royalty. For example, where a person boards a bus or train by purchasing the requisite ticket, it cannot be said that the person is making payment for availing the bus or train on hire as he does not have the control over such equipment. Rather the customer is merely availing the facility of transportation, the consideration for which facility is not in the nature of Royalty.

Recommendations

- It is suggested that Explanation 5 to Section 9(1)(vi) of the Act inserted by the Finance Act, 2012 may be omitted altogether, as this is clearly against the basic principle of the definition of the term royalty provided under Explanation 2 clause (iva) and as also understood internationally.
- Alternatively, in order to avoid ambiguity, the amendment should be modified to objectively provide the rationale behind the insertion of the Explanation 5 and should list out the specific transactions, which it seeks to cover.
- Alternatively, the amendment should have only prospective application.

(c) Clarification on Definition of Process Royalty – Section 9(1)(vi)

In Section 9(1)(vi) of the Act, Explanation 6 was inserted, with retrospective effect from the 1st June 1976, clarifying that the expression 'process' includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret.

Issues

- The amendment may result in inclusion of charges for the use of transponder capacity or connectivity/ bandwidth within the definition of 'Royalty'.
- Services in the nature of provision of transponder capacity or connectivity/ bandwidth are merely facilities provided. As per international tax practices and OECD Commentary, payments for such facilities should not be treated as 'royalty'.
- Explanation 6 even includes payments towards provision of basic telephone service within the ambit of the term 'royalty'. The business income derived by the telecom providers, if classified as royalty, will significantly alter the tax consequences on the receiver of the consideration for the services provided and will burden the payer with TDS compliances.
- Taxation of foreign companies for such facilities and subsequent passing on of the tax cost to India Inc. would entail a significant tax outgo for India Inc., especially companies operating in the field of media and entertainment (satellite and broadcasting companies), IT and ITES companies and telecom.
- The retrospective application of the amendment is grossly unfair and further aggravates the situation.

Recommendations

- In line with international practices and the OECD Commentary, it is suggested that the terms 'transmission', 'up-linking', 'amplification', 'downlinking' could be specifically defined in the Act to remove ambiguity on its scope/ coverage in the definition of 'royalty'
- The definition of the term 'transmission' should explicitly clarify that payments for the use of a 'facility' as a service charge, without any control on the process and where the payer is only interested in the service and not in the use of process, should not be covered within its meaning.
- A clarification should be provided that basic services such as telephone/mobile charges and broadband/ internet connectivity charges, payment to cable operators for viewing the television channels, electricity charges, wheeling/transmission charges paid to state electricity grid or to private electricity transmission companies would be outside the ambit of royalty.
- Alternatively, the amendment should have only prospective application.

Issues

- With the insertion of Explanation 4 and Explanation 6 to Section 9(1)(vi) of the Act, there is an ambiguity as to whether subscription charges paid for download of e-content, access to online database, reports, journals etc. can fall within the purview of "Royalty".
- It has been held by various Courts that the information that is available in public domain is collated and presented in a proper form by applying the taxpayer's methodology and the payment for the same is not to be construed as royalty. It is in line with the international standards and supported by the OECD commentary, which provides that data retrieval or delivery of exclusive or other high value data cannot be characterized as royalty or FTS.
- Taxation of foreign companies/publishers for providing access to such online database or in the form of CD as royalty and subsequent passing on of the tax cost to Indian industry would entail a significant tax outgo for India Inc. and will especially impact the education system in India.
- The retrospective application of the amendment is grossly unfair and would further aggravate the situation.

Recommendations

- It is suggested that the terms 'transmission by satellite, cable, optic fibre or by any other similar technology' could be specifically defined in the Act to remove ambiguity on its scope/coverage definition of 'royalty' and also a detailed circular may be issued elucidating the types of payments covered within the purview of the said terms and thus constituting royalty.
- It is recommended to suitably exclude the payment for the use/access to online databases, reports, journals etc. and any other payments made by the payer from the purview of royalty, which are essentially made for the use of a 'facility' as a service charge and where (a) the payer is only interested in the service and not in the use of process/ technology used for transmission (b) does not have any control on the process/ technology used for transmission.
- Alternatively, the amendment should have only prospective application.

(d) Amendment to the Explanation inserted after Section 9(2)

Issues

- Section 9 of the Act provides for situations where income is deemed to accrue or arise in India. Vide Finance Act, 1976, source rule was provided in Section 9 through insertion of clauses (v), (vi) and (vii) in sub-Section (1) for income in the nature of interest, royalty / FTS respectively. It was provided, inter-alia that in case of payments as mentioned under these clauses, income would be deemed to accrue or arise in India to the non-resident under the circumstances specified therein.
- The intention of introducing the source rule was to bring to tax interest, royalty and FTS, by creating a legal fiction in Section 9 of the Act, even in cases where services are provided outside India as long as they are utilised in India. The source rule, therefore, means that the situs of rendering of services is not relevant. It is the situs of the payer and the situs of the utilisation of services which will determine the taxability of such services in India.
- This was the settled position of law till 2007. However, the Supreme Court, in the case of Ishikawajima-Harima Heavy Industries Ltd (288 ITR 408) held that despite the legal fiction in Section 9 of the Act, for any such income to be taxable in India, there must be sufficient territorial nexus between such income and the territory of India. It further held that for establishing such territorial nexus, the services have to be rendered in India as well as utilised in India.
- This interpretation was not in accordance with the legislative intent that the situs of rendering service in India is not relevant as long as the services are utilised in India. Therefore, to remove doubts regarding the source rule, an Explanation was inserted below sub-section (2) of Section 9 of the Act with retrospective effect from 1st June 1976 vide Finance Act, 2007. The Explanation sought to clarify that where income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of sub-Section (1) of Section 9 of the Act, such income shall be included in the total income of the non-resident, regardless of whether the non-resident has a residence or place of business or business connection in India.
- However, the Karnataka HC, in the case of Jindal Thermal Power Company Ltd. v. DCIT (TDS) (286 ITR 182), has held that the Explanation, in its present form, does not take away the requirement of rendering of services in India for any income to be deemed to accrue or arise to a non-resident under Section 9 of the Act. It has been held that on a plain reading of the Explanation, the criteria of rendering services in India and the utilisation of the service in India laid down by the Supreme Court in its decision in the case of Ishikawajima-Harima Heavy Industries Ltd. remains unaltered and unaffected by the Explanation.

- With a view to removing any doubt about the legislative intent of the aforesaid source rule, the Finance Act, 2010 substituted the existing Explanation with a new Explanation to specifically state that the income of a non-resident shall be deemed to accrue or arise in India under clause (v) or (vi) or (vii) of sub-Section (1) of Section 9 of the Act and shall be included in his total income, whether or not:-
  - the non-resident has a residence or place of business or business connection in India or
  - the non-resident has rendered services in India.
- This was made effective retrospectively from 1st June, 1976. The retrospective nature of the amendment is a cause of concern amongst taxpayers since it would lead to reopening of past assessments.

Recommendation

- The relevant provisions of Section 9 of the Act, in force since 1976, have been interpreted by the Supreme Court in India requiring the taxpayer to also satisfy the condition of 'rendering of service in India' for being taxable in India. It would therefore be only fair to make this provision apply prospectively. Alternatively, a provision be inserted to clarify that past transactions would not be re-opened or contested by the tax officers on the strength of this provision.

4.23.9. Requirement for Non-residents to comply with TDS Obligations - Section 195

The Finance Act, 2012 extended the obligation to deduct tax at source to non-residents irrespective of whether the non-resident has:-

(i) a residence or place of business or business connection in India; or

(ii) any other presence in any manner whatsoever in India.

The aforesaid amendment was introduced with retrospective effect from 1 April 1962.

Issue

- The amendment will result in a significant expansion in the scope of TDS provisions under the Act and will cover all non-residents, regardless of their presence/connection with India.

Recommendations

- In the decision of the Supreme Court in the case of Vodafone International Holdings B.V. [(2012) 345 ITR 1 (SC)], it was observed that the provisions of Section 195 of the Act would not apply to payments between two non-residents situated outside India subject to certain conditions. The Supreme Court also referred to tax presence as being a relevant factor in order to determine whether a non-resident has an obligation to deduct tax at source in India under Section 195 of the Act.
- The amendment by the Finance Act, 2012, however, seeks to expressly extend the scope of TDS obligations to all persons including non-residents, irrespective of whether they have a residence/place of business/business connection or any other presence in India. The amendment should be modified to restrict the applicability of TDS provisions to residents and non-residents having a tax presence in India.
- Alternatively, the amendment should be made effective only prospectively. Making such a provision applicable with retrospective effect will operate harshly on persons who may have made payments based on the law prevalent prior to the amendment.

4.23.10. Taxation of Foreign Dividends and Capital Gains - Section 115BBD and Section 47

- A special tax regime under Section 115BBD of the Act provides for taxing dividend income @ 15% from specified foreign companies (with shareholding of the Indian company of 26% or more).
- Long term capital gains earned by Indian holding company from transfer of shares in foreign companies is taxable in India @20%.

Issues

- The benefit of reduced rate of tax on dividends as per Section 115BBD of the Act is restrictive and is available only to Indian companies only and not to other persons.
- Long term capital gains earned by Indian holding company from transfer of shares in foreign companies is taxable in India @20%.
- There are no provisions under the Act for availing underlying tax credit on dividends and such tax credit can be availed only through a few tax treaties.
- Capital gains arising pursuant to certain business restructuring overseas (viz. amalgamation of foreign companies held by Indian company, demerger) are not exempt.

Recommendations

- The reduced rate of tax on dividends received from a specified foreign company should also be extended to all persons (including a company) as defined in Section 2(31) of the Act.
- Alternatively, tax on such dividends should be treated akin to MAT, creditable against the normal tax liability and payable only if the tax on normal income is less than the tax on such dividends.

4.23.11. Cascading effect of DDT on dividend received from Foreign Companies-Section 115-O

As per the amendment in Section 115-O of the Act vide Finance Act 2013, dividend taxed as per Section 115BBD of the Act received by the Indian company from its foreign subsidiary (i.e. where equity shareholding of the Indian company is more than 50%), then any dividend distribution by such Indian Holding Company to its shareholders in the same FY to the extent of such foreign dividends will not be liable to DDT.

Issue

- As per Section 115BBD of the Act, dividend received from a specified foreign company i.e. a foreign company in which the holding of the Indian company is 26% or more in the nominal value of equity share capital, is subject to tax at a lower rate of 15%. However, as per provisions of Section 115-O of the Act, where dividend is received from a foreign subsidiary (i.e. more than 50% equity shareholding) which is subject to tax @15% under Section 115BBD of the Act, then such dividend will be reduced from the DDT base on any further dividend distributed by the Indian company. In other words, where the Indian company holds 26% to 50% in nominal value of the equity share capital of the foreign company, then such dividend would not be excluded for computing DDT base of the Indian parent.

Recommendation

- It is suggested that the requirement relating to shareholding of more than 50% in the foreign subsidiary for the purpose of Section 115-O of the Act should be reduced to 26%, in the specified company to remove the cascading effect of DDT. Also, the objective of incentivizing repatriation of funds shall be successful when the dividend received from a specified foreign company and distributed by the Indian company is not liable to DDT, thereby removing the cascading effect.

4.23.12. Applicability of Rule 37BB read with Section 195

Issues

- Amended Rule 37BB(3)(i) of the Rules exempts remittances as per the provisions of Section 5 of the FEMA read with Schedule-III i.e. only current account transactions.

  As per Section 5 of the FEMA, any person may sell or draw foreign exchange to or from an authorised person if such sale or drawl is a current account transaction provided that the Central Government may, in public interest and in consultation with the Reserve Bank of India, impose such reasonable restrictions for current account transactions as may be prescribed.

  The Master Direction No. 7/2015-16 dealing with the Liberalised Remittance Scheme (LRS) is a liberalisation measure to facilitate resident individuals to remit funds abroad for permitted current or capital account transactions or combination of both.

  The press release issued by the CBDT on 17 December 2015 states that Form 15CA and 15CB will not be required to be furnished by an individual for remittances which do not require RBI approval under the LRS. However, it may be noted that LRS does not find any specific mention in the amended Rules.

  LRS is a wider term as it includes within its scope both permissible capital and current account transactions. The amended Rules are silent with respect to the capital account transactions under LRS.

- Finance Act 2015 amended sub-section (6) of Section 195 of the Act enhancing the scope of the section to furnish information for all sums whether or not chargeable under the provisions of the Act. Accordingly, the reporting requirement as per section 195(6) of the Act read with Rule 37BB of the Rules would also apply to "Income chargeable under the head Salaries" on which provisions of section 195 itself are not applicable as per sub-section (1) of section 195 of the Act. The issue has resulted in an ambiguity and needs to be resolved.

Recommendation

- Capital account transactions should be specifically included in the exclusion list of Rule 37BB(3)(i) of the Rules read with Section 195(6) of the Act.
- It is recommended that the Government should clarity that the reporting requirement as per section 195(6) read with Rule 37BB will not apply in relation to "Income chargeable under the head Salaries".

4.23.13. Penalty for Failure to furnish Information/Inaccurate information under Section 195

The Finance Act, 2015 has introduced penalty (Section 271-I of the Act) in case of failure to furnish information or furnishing of inaccurate information as required to be furnished under Section 195(6) of the Act, to the extent of INR one lakh.

Recommendation

It is not clear whether the penalty is qua the payment made or qua the transaction or qua the contractual obligations for a specific financial year. Therefore, the same should be clarified in a suitable manner.

4.23.14. TDS from Payments to Non-residents having Indian Branch/Fixed Place PE

Issue

- The corporate tax rate for non-resident companies being 40 (plus surcharge and education cess) results in requiring a non-resident company to file return of income to claim refund of excess taxes deducted. This creates cash flow issues for the non-resident company having operations through an Indian branch unviable, when

compared with its Indian counterparts. This additionally requires the non-resident company to mandatorily approach the tax office to seek a lower TDS certificate, the process being time-consuming and non-taxpayer friendly. Often, the non-resident company faces a lot of difficulties justifying its request for a lower TDS certificate in the initial years of its operations, when it has no past assessments in India. From the tax officer's perspective, this results in excess tax collection by way of TDS only to be refunded later together with interest in addition to significant administrative burden, which may not be commensurate with the benefits of an efficient tax collection mechanism.

Recommendation

- It is recommended that payments which are in the nature of business income of non-residents having an India branch office or 'a place of business within India' should be subject to similar TDS requirements as in case of payments to domestic companies. Further, at the beginning of a tax year, the non-resident taxpayer who has an India branch office or 'a place of business within India' should be permitted to admit PE and opt for a TDS mechanism as is applicable to a resident company. It would go a long way in facilitating ease of doing business in India and the tax officer would be in a position to better monitor and regulate such non-resident companies. Further, it would also achieve the stated objective in the Kelkar Report (December 2002) to abolish the system of approaching the tax officer for obtaining certificates for deduction at lower rates and minimize the interface between the taxpayer and tax officer.

4.23.15. Tax Residency Certificate (TRC)

- The Finance Act, 2012 had provided that in order to be eligible to claim relief under the DTAA, a taxpayer is required to produce a TRC issued by the Government of the respective country or the specified territory in which such taxpayer is resident, containing certain prescribed particulars. Subsequently, the CBDT prescribed the details to be included in the TRC.
- The Finance Act, 2013 has done away with the requirement of obtaining prescribed particulars in the TRC. In other words, the taxpayer can continue to obtain the TRC as issued by the foreign authorities. The Finance Act, 2013 also introduced a provision to clarify that the taxpayer shall now be required to furnish such other information or document as may be prescribed.
- The CBDT subsequently issued a notification amending the Rule 21AB of the Rules, prescribing the additional information required to be furnished by non-residents along with the TRC. The details are required to be furnished in Form 10F.

Issues

- Even though the requirement to furnish TRC containing prescribed particulars has been dispensed with, however, depending on the jurisdiction, obtaining a TRC certificate may also be a time consuming and difficult process. TRC requirement increases the administrative difficulty for non-residents, especially from the perspective of non-residents having very few/ limited transactions connected to India.
- The deductor would like to obtain the TRC at the time of the transaction/ depositing the tax (to ensure that the payee is eligible for DTAA benefits), the payee would typically be able to obtain TRC only after the relevant year.
- As per the Rule 21AB of the Rules, an Indian resident who wishes to obtain TRC from Indian Revenue Authorities, is required to make an application in Form No. 10FA to the tax officer, containing prescribed details. However, no time limit for issue of TRC is specified from the date of application by the taxpayer. Furthermore, the issue of TRC in Form No. 10FB has been left to the discretion of satisfaction of the tax officer, without providing a substantive definition for satisfaction in this regard.

- Rule 21AB of the Rules does not clarify the authority for signing Form 10F, which causes confusion to the taxpayers and the Revenue Authorities.

Recommendations

- The requirement to obtain TRC for a taxpayer to prove that he is a resident of the other state shall be deleted as there may be circumstances wherein the taxpayer who is a bona fide tax resident of the other contracting state is unable to procure a TRC owing to circumstances outside his control. At assessment stage, it is anyway incumbent upon the tax officer to ascertain complete details before allowing DTAA benefits. In such a scenario, even though the tax officer may otherwise be satisfied that the DTAA benefits must be allowed, only owing to the procedural lapse of not obtaining the TRC which is beyond the taxpayer's control, the tax officer would be compelled to deny DTAA benefits, which will cause needless hardship.
- Without prejudice, even if the requirement to obtain TRC must stay, it is recommended that the TRC should be made mandatory only for cases where the total payment to a non-resident exceeds Rs. 1 crore in a FY. This would mitigate hardship in respect of small payments.
- It is also recommended that the requirement to furnish TRC should be cast upon the payee at the time of the assessment of the payee and the deductor/ payer should not be made liable to collect TRC from the payee at the time of TDS.
- The time limit to issue TRC in Form 10FB should be specified and to further specify that in case the tax officer refuses to issue a TRC, the application of the taxpayer should be disposed by the tax officer by passing a speaking order and clearly specifying the reasons for rejecting the application of the taxpayer.
- It may be specified that persons prescribed under Section 140(c) of the Act for the purpose of signing the return of income would be eligible to sign Form 10F.

4.23.16. Clarity on Taxability of Global Depository Receipts

GDR is a foreign currency denominated financial instrument issued outside India by a foreign depository to investors, against an underlying Indian security which is deposited with a domestic custodian in India.

Earlier, GDRs were governed by 'Issue of Foreign Currency Convertible Bonds and Ordinary Shares (through depository receipts mechanism) Scheme 1993' ("1993 Scheme"). Based on the recommendations of the Sahoo Committee and various other stakeholders, the Central Government repealed the 1993 Scheme (excluding provisions governing foreign currency convertible bonds) and replaced it with the Depository Receipts Scheme, 2014 ("2014 Scheme") with effect from December 15, 2014.

Key changes introduced under the 2014 Scheme vis-a-vis the 1993 Scheme, inter-alia, include the following:-

1993 Scheme vis-a-vis 2014 Scheme

(a) GDRs could be issued only by Indian listed companies. GDRs can be issued by both listed and unlisted Indian companies whether public or private.

(b) GDRs could be issued only against underlying shares. GDRs can be issued against underlying permissible securities such as shares, debt instruments etc.

(c) The Scheme specifically laid down the manner of taxation on conversion of GDRs into shares. The Scheme is silent on the manner of taxation on conversion of GDRs into shares/securities.

It may be pertinent to note that section 47(viia) of the Income Tax Act, 1961 ('the Act') provides for specific exemption on transfer of GDRs from one non-resident to another non-resident outside India. However, the Act was

silent with respect to cost of acquisition ("cost") and period of holding ("period") to be considered of underlying shares which will be received on conversion of GDRs into shares.

The Finance Act 2015 ("FA 2015") now provides that on conversion of GDRs into the underlying listed company shares, the cost of the shares should be the price prevailing on a recognised stock exchange on the date of advice for conversion and the period of holding shall be reckoned from such date. However, the cost and period in a scenario where GDRs are issued against unlisted shares or other permissible securities such as debentures etc. have not been specified as the FA 2015 only prescribes the mechanism for determining the cost and period in case of "listed shares". Also, the definition of GDR as per Explanation to section 115ACA of the Act has been changed to provide that Global Depository Receipts" means any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India and issued to investors against the issue of,—

(i) ordinary shares of issuing company, being a company listed on a recognised stock exchange in India; or

(ii) foreign currency convertible bonds of issuing company

As a result of the above amendment made in Explanation to section 115ACA of the Act, there is an apprehension that a tax officer can deny the exemption on transfer of GDR made outside India by a non-resident to another non-resident if such GDR has been issued against the shares of an unlisted Indian company. It can be alleged that exemption under section 47(viia) of the Act is only in respect of GDR issued against shares of a listed Indian company. However, it is a well settled position that transfer of GDRs outside India by a non-resident to another non-resident is not taxable in India. The amendment made by Finance Act, 2015 is also not in line with 2014 Scheme which provides that GDRs can be issued by both listed and unlisted Indian companies whether public or private. The ambiguity created by the amendment can be a huge dent to the start-up investments. This will have an impact of relocating new start-ups to other locations. Such kind of distinction created between listed and unlisted companies (due to change in the definition of GDR) also does not serve any purpose as the GDRs have to be listed on a stock exchange outside India which is sufficient to bring transparency in trading of these GDRs.

FICCI recommends that the Government should specifically provide that the tax benefit on GDRs issued against the ordinary shares of an unlisted company will be in parity with GDRs issued against shares of a listed company, as long as these GDRs are traded on a recognised stock exchange outside India.

4.24. Mergers & Acquisitions

4.24.1. MAT Credit - Section 115JAA

Issues

- MAT credit is akin to advance payment of tax.
- Benefit of MAT credit cannot be denied to successors in case of reorganization.

Recommendation

- Section 115JAA of the Act should be amended to provide that successors in case of amalgamation, demerger or any other form of reorganization should be eligible to claim benefit of MAT Credit.

4.24.2. TDS and Advance Tax Credit

Issue

- Where there is amalgamation or merger or demerger, tax officers deny the TDS/advance tax credit available to the amalgamating/demerged entity in the hands of resulting entity during the course of assessment proceedings.

Recommendation

- Advance tax paid by the demerged company or amalgamating company on behalf of the resulting company or amalgamated company or TDS available to demerged company/amalgamating company should be given appropriate credit.

4.24.3. Carry Forward and Set off of Accumulated Losses in Amalgamation or Merger

Issues

- Currently, Section 72A of the Act allows carry forward of loss and accumulated depreciation in case of amalgamation/ demerger of the following type of companies:-
  - a company owning an industrial undertaking or a ship or a hotel with another company,
  - a banking company,
  - one or more public sector company or companies engaged in the business of operation of aircraft.
- Apparently, the benefit is not available to all the companies engaged in the business of providing services. Considering the facts that many multinational companies have entered in the Indian service market and it has become imperative for the small companies to consolidate their resources to survive, the benefit applicable under the provision of Section 72A of the Act should be extended to all companies irrespective of their line of operations.
- More so, Section 72A(2) of the Act prescribes stringent condition about continuity of holding of assets by the amalgamating company for at least 2 years prior to transfer and by the amalgamated company for 5 years post transfer. Similarly it requires that the amalgamating company should be in the business for at least 3 years prior to the amalgamation. The conditions in the hands of the amalgamated company are sufficient to control misuse of the provisions and therefore, the conditions applicable to the amalgamating company should be deleted. Also, holding of assets and continuation of business for 5 years is quite a long period.
- Where such loss of specified business under section 35AD of the Act is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company.

Recommendations

- Section 72A of the Act should be amended to allow benefit of carry forward of losses, pursuant to amalgamation, to all companies irrespective of their line of business especially services business.
- Section 72(A)(2) of the Act be amended to delete conditions under sub-clause(a) relating to amalgamating company.
- Also, Section 72A(2)(b) of the Act should be amended to reduce the period of holding assets and carrying on of business to 3 years.

4.24.4. Clarity on Restriction on Carry Forward and Set off of Losses - Section 79

Issue

The extant provisions of section 79 of the Act restrict closely held companies from carrying forward and setting off losses in case shareholding varies by 49 percent or more in the year in which the loss is considered to be set off vis-a-vis the year in which the loss is incurred.

In the event of a business reorganization by which a holding company transfers the shares of its 100% subsidiary to another subsidiary, the first subsidiary will not be in a position to carry forward and set-off its losses (if any) as there is a 100% change in its shareholding. However, in such a situation, the holding company continues to hold 100% of the shares of the second subsidiary, which in turn holds 100% of the shares of the first subsidiary. There are conflicting decisions of the courts on this issue, one view point is that the immediate change in shareholding should be tested whereas other view point is that the ultimate change in shareholding should be tested, in order to invoke rigors of section 79 of the Act.

Recommendation

It is recommended that necessary clarification be provided by the Government to settle the ambiguity surrounding on this issue.

4.24.5. Change of Rate of Tax on Sale of Units of a Mutual Fund - Section 112

Issue

- The concessional rate of tax of 10% on long term capital gain is no more available to the units of a mutual fund. This amendment in Section 112 would again impact debt schemes of Mutual fund (MF)

Recommendation

- This proposal should be dropped and accordingly beneficial rate of tax (i.e. 10%) should continue to be made applicable as earlier on such schemes.

4.24.6. Grossing-up of a Dividend Distribution Tax in relation to Mutual Fund - Section 115R

Issues

- The Finance (No. 2) Act, 2014 has amended Section 115R wherein the DDT in relation to the unit holders is required to be grossed up. Accordingly, the DDT to be paid after grossing up of the amount distributed as dividend.
- This amendment in Section 112 would impact debt schemes of Mutual fund (MF)

Recommendation

- This amendment should be deleted and the erstwhile method of computation of DDT should continue to be applied on income distributed by a mutual fund. Grossing up effect is especially very steep in the case of mutual funds on account of the higher DDT (vis-à-vis Dividend on shares).

4.24.7. Status of Widely held Company to be considered on date of Transaction

Issues

- Section 2(18) of the Act defines widely held company. This definition has wide implication on carry forward of loss, taxability under Section 56(2) of the Act and in various other provisions.
- It includes a listed company, only if its shares are listed on exchange as on last date of the relevant year. Further, it includes subsidiary of listed company, only if the shares of such subsidiary were held throughout the relevant year by the listed company. These provisions lead to situations which does not seem intended.
- Therefore, it stands logical that the conditions of listing, holding of shares etc. should be subject matter of test on the date of transaction and should not be stretched to be continuing till the end of that FY.

Recommendation

- Section 2(18) of the Act should be suitably amended to provide test of conditions on the date of relevant transaction.

4.24.8. Transactions without consideration or for inadequate consideration

Issues

- The Finance Act, 2010 inserted clause (viia) in Section 56(2) of the Act with a view to curb abusive transactions.
- Section 47 of the Act and other provisions of the Act exempts certain transactions from taxation. However, proviso to Section 56(2)(viia) of the Act excludes only a part of such exempted transactions from its applicability. Consequently, those transactions which may otherwise be exempt under Section 47 of the Act are still liable to tax under Section 56(2)(viia) of the Act.
- Section 56(2)(viia) of the Act is applicable to receipt of shares without consideration or with inadequate consideration. These are anti-abuse provisions intended to curb tax avoidance. Consequently, it should be applicable to transactions liable to tax and not otherwise. Thus, this Section should be applicable to receipt of shares which are not covered under Section 47.
- Without prejudice to the above recommendation, it needs to be clarified that the following transactions would be excluded from its ambit:-

  Issue of shares including:-

  – right issue

  – Preferential allotments

  – Conversion of financial instruments

  – Bonus shares

  – Split/subdivision/consolidation of shares.

  – Receipt pursuant to stock lending scheme.

  – Receipt by Trustee Company.

  – Buyback of shares.

  – By offshore investors in cases where purchase price is determined by Indian laws in force (e.g. SEBI rules, FEMA guidelines).

  The amendment will adversely impact genuine cases where the shares are transferred at a pre-determined price for agreed commercial and bonafide considerations. For example:

- Joint venture or investment agreements particularly for unlisted company, frequently make provisions for put and call options to be exercised at agreed prices, which are compliant with all relevant exchange control and related laws, though they may not necessarily be at fair market value. This is, often, to permit Indian promoters to enjoy some upside benefit if their companies perform better than the rate of return expected by the investor. To levy income-tax liability on such promoters purely on a notional unrealized gain, when they acquire shares from the investors at the negotiated price is clearly unwarranted and, possibly, unintended.
- Likewise, there may be default forced sale provisions in such agreements that allow a non-defaulting party to acquire shares from a defaulting party at a price below market value. Again, to tax the non-defaulting acquirer for the discount would be unfair and possibly, also unintended.

Recommendations

- All transactions which are specifically exempted from capital gains tax under Section 47 of the Act or other provisions of the Act should be kept outside the purview of the said Sections 56(2)(viia) of the Act.
- Section 56(2)(viia) of the Act should not be made applicable to genuine business/commercial transactions.
- Section 56(2)(viia) of the Act should be suitably amended to provide that the Section should be applicable only if the shares being received by the taxpayer are in existence and held by another person.
- Rule 11UA of the rules should be suitably amended to value unquoted equity shares on a fully diluted basis.

4.24.9. Amalgamation/Demerger into Parent/ Subsidiary/ Co-subsidiary - Section 47

Issues

- Section 47 of the Act exempts certain transactions from being taxed under the head 'capital gains' by specifying such transactions not to be regarded as 'transfers' under Section 45 of the Act.
- Sub-Section (vii) of Section 47 of the Act states:

  "any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if-

  (a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where shareholder itself is the amalgamated company.

  (b) the amalgamated company is an Indian Company."
- Section 42 of the Companies Act 1956/ 19 of the Companies Act, 2013 does not allow a subsidiary company to hold shares in the parent company. Pursuant to such merger, in case where subsidiary was holding shares in transferor company, the parent company cannot allot shares to it.
- Section 2(19AA) of the Act defines 'demerger' and specifies conditions which are conflicting in nature. First condition requires that at least 75% shareholders of transferor company should become shareholders of transferee company. Second condition provides that shares should be issued to the shareholders of the transferor company on a proportionate basis. If one logically reads the two conditions, it means that shares should be issued on a proportionate basis to the shareholders of demerged company, to whom shares are issued under first condition. However, to avoid litigation, clarity needs to be provided.
- Section 41 of the Act provides that certain income subject to conditions, relating to business of predecessor, will be taxable in hands of successor even though it arises post succession. However, similar provision is not there in Section 43B, 35DD etc. of the Act where expenses need to be claimed post restructuring in hands of successor.

Recommendations

- Section 47(vii) of the Act should be extended to specifically cover:-
  - shareholder of amalgamating company being subsidiary of amalgamated company
  - Amalgamation of direct subsidiary with step-down subsidiary,
  - Amalgamation involving amalgamating company holding shares in amalgamated companies.
- Section 2(19AA) of the Act be amended to provide that the shares of the resulting company should be issued on a proportionate basis to the shareholders of demerged company to whom shares are issued under first condition. It should be clear that proportionate basis does not apply to all the shareholders.

- A new Section be inserted in chapter IV providing that in case of reorganization, deduction in relation to:-
  - to expenditures incurred in pre-reorganisation period but allowable during post-reorganisation period and
  - expenditures incurred during the previous year but allowable on certain criteria, for e.g. payment basis under Section 43B of the Act, etc. will be allowed to successor as it would have been allowed to the predecessor.

4.24.10. Conversion of one type of Share into other type of Share of the same Company

Issues

- Section 47(x) of the Act provides that, any transfer by way of debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company, will not be treated as a 'transfer' for the purposes of Section 45 of the Act. Section 49(2A) of the Act provides that, where a share or debenture in a company, became the property of the taxpayer on such conversion, the cost of acquisition to the taxpayer shall be deemed to be that part of the cost of debenture, debenture-stock or deposit certificates in relation to which such share or debenture was acquired by the taxpayer.
- It is noteworthy that while inserting clause (x), the intent of the legislature was that no taxable capital gains can arise at the time of conversion of convertible debentures, deposit certificates or shares of the company into debentures or shares of that company, since it amounts to conversion of an asset held by a taxpayer from one form to another and no other party involved to whom any transfer is made. In fact, clause (x) of Section 47 of the Act was further amended by the Finance Act, 1992 to include 'bonds' in the said provision.
- However, it appears that there has been an inadvertent omission in both the foregoing provisions, i.e., conversion of preference shares or warrants into equity shares of a company have not been specifically covered under the said provisions. Similar to Section 49(2A), Section 55(2)(b)(v) of the Act provides that cost of shares received on conversion should be cost of the shares which were converted. Thus, there does not seem to be any difference in taxing of conversion of debenture or share. However, legislature has missed to provide exemption to conversion of preference shares.

Recommendations

- Section 47(x) of the Act should be amended to include cases of conversion of one type of shares or warrants into shares or other type of shares.
- Section 47(x) of the Act should be amended to include cases of conversion of loan/ECB into shares or other type of shares. This could be limited to loans which have terms/ features similar to debentures and bonds.
- Section 2(42A) of the Act should be amended to provide that the period of holding of earlier instrument should be included for computing the period of holding of new instrument.

4.24.11. Transfer of Capital Asset between Holding Company and Subsidiary –Section 47

Issues

- Under the existing provisions of clause (iv) and (v) of Section 47 of the Act, transfer of a capital asset by a holding company to its subsidiary company and vice versa is not regarded as a 'transfer' for the purposes of capital gains if inter-alia, the parent company holds whole of the share capital of subsidiary company.
- In order to carry out business in today's challenging business environment, business houses create multilayer corporate structure for complying with various regulatory and contractual requirements as well as risk ring fencing for its lenders.

Recommendation

- It is therefore, suggested that benefits of clause (iv) and (v) of Section 47 may be extended to step down subsidiaries where the parent company holds whole of share capital of such subsidiary directly or through other 100% held subsidiary.

4.24.12. Non-Compliance of conditions applicable to certain Re-organizations - Section 47

Issues

- Section 47A(1) of the Act provides that in case holding company does not continue to hold 100% of shares of the subsidiary company or converts/treats the transferred asset as stock-in-trade, within a period of 8 years from the date of the transfer of capital asset, the gains exempted under Section 47(iv)/ (v) of the Act shall be taxable in the hands of the transferor company in the year of transfer. It shall be noted that a period of 8 years is too long.
- Further, in any case such income should be taxable in the year of event specified in the Section and not in the year of transfer of capital asset.

Recommendations

- Section 47A (1) of the Act should be amended to reduce "period of 8 years" to reasonable period.
- Further, in any case, such income should be taxable in the year of event specified in the section and not in the year of transfer of capital asset.
- Words 'profits & gains' in Section 47A(1) of the Act should be replaced with the word 'income'.

4.24.13. Conversion into Limited Liability Partnership/ Conversion of Firm into Company

Issues

- Section 47(xiiib) of the Act provides tax neutrality to conversion of Company into LLP subject to certain stringent conditions. Such conditions should be made less stringent or some relaxation should be provided in application of the same as discussed below:-
  - It is available only to a Company having Turnover of less than Rs. 60 lakhs for 3 years prior to such conversion. In the current economic scenario, this limit of Rs. 60 lakhs needs to be removed. There is no reason, why companies with large turnover, which otherwise qualify, should not be eligible for conversion with tax neutrality.
  - Another condition is that all the shareholders of the company, immediately before the conversion, should become partners of the LLP. This condition should be made applicable only in respect of equity shareholders and not preference shareholders, since preference shares are in the nature of quasi equity.
  - Further, it is necessary that the aggregate of the profit sharing ratio of the shareholders of the company, in the LLP shall not be less than 50% at any time during the period of five years from the date of conversion. This condition should be applicable only to voluntary transfers and not to all the transfers. Say, this condition should not apply in case of dilution resulting from death or disqualification of a partner or amalgamation of a corporate partner.
  - For claiming tax neutrality, it is provided that accumulated profits of the company as on the date of conversion should not be paid to the partners of the LLP for a period of three years from date of conversion. Under the Act, LLP is considered akin to a partnership firm and there is no restriction on distribution of the profits of the partnership firm. Further in case of firm, there is no requirement to show reserves and

surplus separately, but the same is credited to partner's capital account. Thus, there should not be any restriction on LLP in relation to payment out of profits. Further, the term accumulated profits is not defined and may include other reserves also.

- MAT payment under Section 115JB of the Act is prepayment of taxes actually becoming due in subsequent years under normal provisions of the Act. Consequently, Section 115JAA of the Act allows credit for such payments in the year the company becomes liable to pay tax under normal provisions of the Act. There is no reason, why such credit should not be allowed to LLP, which is converted from a company eligible to such credits, if it is paying taxes under normal provisions of the Act.
- Section 47(xiii)/(xiiib) and (xiv) of the Act requires that the members of the firm/ shareholders of the company should continue to maintain profit sharing/ shareholding for 5 years. It should be noted that 5 years is a fairly long time and therefore, it should be restricted to 3 years.
- Section 47A(4) of the Act provides that in case of non-compliance of any condition provided in Section 47(xiiib) of the Act, the gains on conversion of company/ transfer of shares shall be the profits & gains taxable in the hands of the LLP/ shareholders in the year of such non-compliance. Similarly, proviso to Section 72A(6A) of the Act provides that in case of non-compliance of any condition provided in section 47(xiiib) of the Act, the losses/unabsorbed depreciation of the company utilized by the LLP shall be income of the LLP for the year of such non-compliance.
- Section 47A(3) of the Act provides that in case of non-compliance of any condition provided in Section 47(xiii) or (xiv) of the Act, the gains on conversion of partnership or proprietary concern shall be profits & gains taxable in the hands of the Company in the year of such non-compliance. Similar to Section 72A(6A), 72A(6) deals with cases covered under Section 47(xiii) and (xiv).
- The conversion of a company into LLP will become all the more difficult now as a result of amendment made in section 47(xiiib) of the Act by the Finance Act 2016 which denies exemption in a case where the company was possessed of total assets worth Rs. 5 crores in any of the 3 prior years. Also, the expression "total value of the assets as appearing in the books of accounts" is not defined and may create certain interpretational issues such as whether status of assets is to be seen on balance sheet date or even one day's presence during the year will be considered even if asset no longer exists with the assessee as on balance sheet date. Also, whether 'Miscellaneous Expense' and Advance tax (with corresponding provisions for tax on liability side), etc. reflected on asset side of balance sheet will constitute an asset, are the other issues which need to be addressed.

Recommendations

- Turnover criteria should be removed from Section 47(xiiib) of the Act.
- Words "equity shareholder" should substitute the word "shareholder" wherever it appears in Section 47(xiiib) of the Act.
- Insert proviso under clause (d) in proviso to Section 47(xiiib) of the Act to provide that it should not be applicable to a case where a change in profit sharing takes place consequent to death of a partner or pursuant to any other transaction covered under Section 47 of the Act.
- Condition of non-payment out of accumulated profits specified in clause (f) to proviso to Section 47(xiiib) of the Act should be removed. If not removed, term accumulated profit should be appropriately defined.
- Provisions of Section 115JAA of the Act allowing utilization of MAT credit should be amended to allowed credit for MAT paid by the company to the successor LLP.

- Sections 47(xiii)/(xiiib)/(xiv) should be amended to reduce period of continuing same profit sharing/shareholding from 5 years to 3 years.
- Words profits & gains in Section 47A(3)/(4) of the Act should be replaced with the income.
- In view of making conversion of a company into a LLP more liberal, it is recommended that the condition of asset base being less than Rs. 5 crores be rationalised. Further, the scope of the term 'total value of the assets as appearing in the books of accounts' be clarified to provide certainty and reduce litigation.

4.24.14. Continuation of Deduction under Section 80-IA in case of Re-organization

Issues

- Section 80-IA of the Act provides deduction in relation to profits of certain undertakings. It was well settled that in the case of restructuring of any entity owning such undertaking, the benefits of deduction will be available to entity owning the undertaking post restructuring.
- Board Circular Letter F.No. 15/5/63-IT (AI), dated 13th December, 1963 specifically provided that in the year of corporate restructuring, the benefit shall be available to transferor entity up to the date of transfer and to the transferee entity for the remaining period of tax holiday.
- Sub-Section (12) provided that in the year of restructuring deduction will not be allowable to the transferor entity but same will be allowed to the transferee entity as it would have been allowed, had the restructuring not taken place. In totality, this will restrict the total period of deduction to not more than the total period for which the deduction should have been allowed under the provisions of the Act.
- However, sub-Section (12A) was inserted in Section 80-IA with effect from 1st April, 2008 to provide that nothing contained in sub-Section (12) shall apply to reorganization post 1st April, 2007. A view is expressed that post insertion of sub Section (12A), benefit of deduction under Section 80-IA of the Act will not be available to the amalgamated/ resulting entity.

Recommendations

- Section 80-IA(12A) of the Act be deleted to enable restructuring of eligible entities.
- Section 80-IA(12) of the Act should be amended to provide for allowing deduction to the amalgamating/ demerged entity for the period till transfer date and to the amalgamated/ resulting entity post transfer.

4.24.15. Amendment to Section 68

The first proviso to Section 68 of the Act provides that in case of closely held company share application money shall be considered as income of the company unless the investor provides necessary explanation to the satisfaction of the Assessing Officer.

Issue

- This amendment is not needed and desirable. Any tax avoidance which is structured through excessive securities premium could be brought under the purview of GAAR provisions through adequate methodology and rules. The overall principles enunciated under GAAR provisions to treat an arrangement as Impermissible Avoidance Arrangement should be applied to the share subscription transaction for determining the taxability of securities premium account in the hands of company.
- This amendment may overlap with provisions of Section 56(2)(viib) of the Act and may be taxed twice.

Recommendation

- It is suggested that the first proviso to section 68 should be deleted.

Issue

- Section 68 was amended to provide that the nature and source of any sum credited, as share capital, share premium etc. in the books of a closely held company shall be treated as explained only if the source of funds is also explained by the assessee company in the hands of resident shareholder. However, it has been observed that the assessing officers have been applying the provision to sums obtained from non-resident investors also. Further, despite providing sufficient evidence as to the identity and credit worthiness of the non-resident investors, the tax officers without reasonable basis and after having the necessary information as to the identity and credit worthiness of the non-resident investor, examine even the source of source of funds of such non-resident investors. This has led to unnecessary harassment being faced by the non-resident investors on account of submission of information which has even no co-relation with the assessment of the investee company.

Recommendation

- It is recommended that the Government should suitably clarify and restrict the scope and depth of examination/ scrutiny to be exercised by the assessing officers with respect to the non-resident investors. It is also recommended that the application of this provision be made by the tax officer after pre-approval of Principal Commissioner of Income-tax/Commissioner of Income-tax, on the basis of tangible material/evidence brought on record by the tax officer.

4.25. Capital Gains

4.25.1. Issues under Section 54EC of the Act

Issues

- Section 54EC of the Act provides tax exemption on capital gains arising from the transfer of a long term capital asset, if invested in long-term specified assets within a period of six months from the date of such transfer. The investments in such bonds, in a FY and the subsequent FY, should not exceed Rs. 50 lakhs.
- Further, there might be a situation where, the specified assets are not available during the said period of six months. Also, it may be possible that the price/ rate/ cost at which the specified asset is available during the stipulated period may not be viable for the taxpayer to invest.
- Purpose behind granting of exemption is to promote investment in specified assets. There does not seem to be any rationale behind prescribing the monetary limit of Rs. 50 lakhs per investor or specifying the stringent time line of 6 months. Especially in the context that such funds would in any case be used for meeting the infrastructure requirements.
- The specified assets for the purpose of section 54EC are only bonds issued by National Highways Authority of India or by Rural Electrification Corporation Limited. The Government should also include 'mutual fund units' within the purview of specified assets to channelize more investments in the capital markets.

Recommendations

- Currently, huge amounts are required to be deployed in the infrastructure sector to give the sector the much needed boost and this vehicle could be used for raising such infrastructure development funds. Thus, there is a need to revisit the limits prescribed.

- Moreover, the interest income on such bonds, which are presently fully taxable, should be awarded 'non-taxable' status.
- Proviso to Section 54EC(1) of the Act which restricts the investment in such bonds not exceeding Rs. 50 lakhs in a FY should be deleted.
- Recently inserted Second Proviso to Section 54EC(1) of the Act should also be deleted which restricts the investment in the FY of transfer and its subsequent FY, with respect to the asset transferred, in such bonds not exceeding Rs. 50 lakhs.
- The time period of 6 months should be liberalized and the exemption should be permitted for the investments made before the due date of filing of return of income under Section 139(1) of the Act.
- The list of specified assets should be broadened by including mutual fund units redeemable after three years.

4.25.2. Cut-off date for ascertaining Cost and Index Factor - Section 48/55

Issues

- Section 55 (2)(b) (i) and (ii) of the Act provides that in case of asset acquired before 1 April 1981, taxpayer has an option to replace cost of such asset by market value thereof.
- Section 48 of the Act provides that for computation of long term capital gain, "indexed cost of acquisition" is deductible from the full value of the consideration received from the transfer of certain capital assets. Indexed cost means cost of acquisition adjusted for inflation index. Again, base for ascertainment of index factor is 1st April, 1981. Cost Inflation Index is notified every year having regard to 75% of average rise in the Consumer Price Index for urban and non-manual employees for the immediately preceding previous year to such previous year. It may thus be seen that such indexation benefit is notional and does not take care of full inflationary impact and causes inequities to the taxpayers. Thus, the cut-off date for cost replacement and base for index being 30 year old needs to be revised.
- Further, in case of taxpayer, acquiring assets through specified modes, period of holding of earlier transferor is added to period of holding of taxpayer, however, index benefit is allowed only from the date of holding of the asset by the taxpayer. This seems to be an unintended anomaly and needs to be set right.

Recommendations

- Cut-off date for cost replacement in Section 55 of the Act and for index factor in Section 48 of the Act should be shifted to 1st April 2001.
- Index benefit even to the taxpayer acquiring assets through specified modes should commence from the date of acquisition in the hands of original purchaser.

4.25.3. Rate of Tax Applicable to Short-Term Capital Gains - Section 111A

Issues

- Section 111A of the Act provides that short-term capital gains on sale of shares of listed companies or units of equity oriented fund should be taxed at 15%. The rate was 10% till 31 March 2009.
- The difference between normal income and capital gain arising on transfer of assets is well recognized even under the Act. It is a known fact that owner of an asset incurs a lot of expenditure for maintaining an asset. In case such asset is used in business, deduction is allowed for such maintenance and other expenses. However, no such deduction is allowed if such asset is a non-business asset. Thus, it makes a strong case that rate of tax in

case of capital gains should be different from the rate applicable to other incomes. This distinction is recognized to some extent in Section 111A and 112 of the Act. However, for short term gains on assets other than listed shares, such difference is not recognized.

Recommendations

- The rate for listed shares should be restored to 10% as was the position till 31st March 2009.
- Section 111A of the Act should be amended to provide the rate of tax for short term gain on transfer of assets other than listed shares to be at 20%.

4.25.4. Abolition of Tax on Gains arising from transfer of Listed Securities

Issues

- In case of the taxpayer who is an investor and is also engaged in the business of trading in securities, there is an ongoing dispute as to the taxability of the gains arising on account of the transfer of the shares held as investment.
- As per National Stock Exchange, India is one of the costliest destinations to trade in securities. STT, along with other taxes, and high brokerage structure makes trading in securities in India almost five-six times higher than in advanced countries.

Recommendations

- At present, only the long term capital gains arising on transfer of listed shares routed via a recognized stock exchange are exempt. Various courts have laid down guidelines to determine the nature of the gains. The guidelines are based on the facts of the particular case and cannot be applied to all the cases, therefore, leaving the issue unresolved and causing undue hardships to the taxpayers.
- The Shome Committee Report on 1st September 2012 on GAAR recommended that the Government should abolish the tax on gains arising from transfer of listed securities, whether in the nature of capital gains or business income, to both residents and non-residents.
- Hence, it is recommended that the capital gains tax levied on the transfer of listed securities be abolished.
- Alternatively, suitable amendments should be brought in the Act, to provide a clear distinction between the income from trading activities & income from investment activities.

4.25.5. Insertion of Section 50D in the Act

Section 50D is inserted to provide that in cases involving transfer of assets, if the consideration is not determinable, fair value of the consideration received or accruing shall be deemed to be consideration.

Issues

- Method of determining fair value is not specified under the Act.
- Section overlaps with certain other Sections providing similar mechanism for determining consideration, e.g. Section 45(3) dealing with transfer of a capital asset.

Recommendation

- Method for determination of fair value should be specified under the Act. Applicability of Section 50D of the Act should be restricted to the transactions not covered under other similar provisions.

4.26. Transfer Pricing

4.26.1. Transfer Pricing - Marketing Intangibles

Issues

- Marketing intangibles are crucial sources of value and its value is derived from the company's levels of Advertising, Marketing and Promotion expenditures (AMP) which adds intrinsic value to a company. Revenue authorities are increasingly scrutinizing the cross border transfer, use and further development of intangibles relating to brand and licenses. The ruling of the Delhi HC in the case of Maruti Suzuki India, which discusses the creation and compensation for marketing intangibles only, underlines this trend. Further, the Special Bench of the Delhi Tribunal in the case of LG Electronics India Pvt. Ltd. held that transfer pricing adjustment in relation to AMP expenditure incurred by the taxpayer for creating or improving the marketing intangible for and on behalf of the foreign Associated Enterprise (AE) is permissible. It also held that the said function can be construed as provision of service by the taxpayer to the AE for which, earning a mark-up in respect of AMP expenditure incurred for and on behalf of the AE, is appropriate.
- Recently, the Delhi High Court in the case of Sony Ericsson Mobile Communication India Pvt. Ltd. and several other connected matters upheld the tax department's jurisdiction to consider AMP expenditure as an international transaction subject to transfer pricing. The High Court further held that various legal ratios accepted and applied by the Income-tax Appellate Tribunals relying upon the Special Bench ruling in the case of LG Electronics as erroneous and unacceptable. The High Court held that distribution and marketing are intertwined functions and can be analyzed together as a bundled transaction and that segregation of non-routine AMP expenditure using the bright line approach is not appropriate. In line with the findings of the Delhi Tribunal in the case of BMW India Private Limited, the High Court also held that separate remuneration for the AMP activities may not be required if such compensation is already provided by way of lower purchase price or reduced payment of royalty. It has been observed by the High Court that, for justifying argument of "margin", selection of comparables, having similar intensity of functions on account of AMP, as the taxpayer, is crucial. Proper adjustments are suggested by the High Court to eliminate the material differences. However, High Court did not provide guidance on the nature of adjustments that may be required.
- In light of the amendment introduced vide Finance Act 2012 which specifically includes marketing intangibles in the expanded definition of international transactions, the Special Bench ruling in the case of LG Electronics India Pvt. Ltd., and the High Court's judgment in case Sony Ericsson and BMW India, identifying a transaction relating to marketing intangible development and substantiating the arm's length compensation for the transfer price of the intangibles would pose great challenges without specific guidance relating to these aspects in the Indian transfer pricing regulations.

Recommendation

- Accordingly, in line with the Organization for Economic Co-operation and Development (OECD) principles and recommendations given by the OECD under Action 8 of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Action Plan, guidance should be issued to recognize certain methodologies/ approaches for evaluating the arm's length character of transactions involving marketing intangibles.

4.26.2. Transfer Pricing of Manufacturing Intangibles

Issues

- Compensation for use of manufacturing intangibles has generally been in the form of royalty payouts and is commonly benchmarked by adopting the aggregated approach.

- However, this approach is increasingly challenged by the Revenue Authorities, who insist on adopting transaction-specific approach, and the taxpayer is required to substantiate the economic and commercial benefits derived from the royalty payout.

Recommendation

- With the removal of the limits exchange control that was prescribed by the Foreign Exchange Management Act Regulations, it is necessary that guidance be provided to test such transactions particularly in cases of start-up or loss making companies.

4.26.3. Transfer Pricing of Intra Group Financial Transactions/ Management Services

Issues

- Management services are services where an entity in a multinational group renders shared services in the nature of legal, administrative, human resources, information technology, finance, sales/marketing, etc. to its group affiliates.
- One of the important issues that draw the attention of the Revenue Authorities is the arm's length nature of the compensation paid for such intra-group services to related entities. Another important aspect is demonstrating the benefits derived by the service recipient. The entire onus to substantiate the arm's length payment and benefit received and establishing the 'cost-benefit' analysis by way of maintaining service agreements, basis of charge out rates, allocation keys, evidence of services/ benefits received etc., is upon the taxpayer.

Recommendation

- Accordingly, in the absence of any guidance or industry benchmarks in public domain for testing payments towards intra-group services, detailed guidelines in line with the OECD principles and recommendations given by the OECD under Action 10 of the OECD/G20 BEPS Action Plan,, for maintaining specific documentation outlining the various costs incurred in relation thereto and the related benefits derived there from, should be introduced in the regulations. Even the concept of Low value-adding intra-group services as recommended in discussion draft to Intra-group services issued under the above-mentioned Action Plan should be introduced which will result in stream lining the taxpayers and the Revenue authorities' resources towards more high-value transactions.

4.26.4. Interest on Inter-Company Loans and Guarantee fees

Issues

- Transfer pricing of cross-border financial transactions deals with inter-company loans, debentures, corporate guarantee charges, cash-pooling arrangements, debtors discounting, etc., and intends to arrive at arm's-length outcome in a related-party scenario. Typically, interest rates on loan transactions between third parties depend on factors like borrowers' credit rating, loan tenor, prevailing market conditions, loan seniority, security to lender(s), etc.
- The Comparable Uncontrolled Price (CUP) method, which is commonly used for arriving at arm's-length interest rates for intra-group loan transactions, demands a high degree of comparability and necessitates complex adjustments. Pricing a guarantee is even more challenging in the absence of comparable data and warrants application of sophisticated transfer pricing techniques. In India, lack of guidelines often leads to application of arbitrary methods for pricing of inter-company financial transactions. The Tribunal has laid emphasis on the credit quality of the borrower while holding that inter-company loans should attract arm's-length interest charge. Further, vide the Finance Act, 2012, the definition of international transactions has been expanded to specifically include capital financing, including any type of long-term or short-term borrowing, lending or

guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business which would now give rise to a whole gamut of such financial transactions to be reported by the taxpayer.

Recommendation

- Given the increasing global trend of cross border financing and inter-company lending, it is of paramount importance to introduce appropriate guidance governing the pricing of inter-company funding. Further, considering the increased amount of litigation pertaining to the inter-company loans and guarantee transaction, with no clear view of the higher appellate authorities, appropriate clarification on the approach/methodology to be adopted for analyzing these transactions is required.

4.26.5. Country by Country Report

(a) Penalty for non-furnishing of Country by Country Report

Issue

Section 271GB of the Act prescribes stringent penalty for non-furnishing of Country by Country (CbyC) report as prescribed in section 286 by the due date.

The deadline for filing the CbyC report in India is 30 November 2017 for first covered FY 2016-17 i.e. only 8 months post the end of FY 2016-17 have been provided to the taxpayers to prepare and furnish the CbyC report.

Recommendation

There is a need to rationalise penalty for the filing requirements in the first year at least as even OECD's guidelines under BEPS Action Plan 13 provide for a 12 month period in the first year of filing. Accordingly, partial relief from the stringent penalties should be provided for the first year of CbyC report filing, such that penalty is applicable for CbyC report filed on or after 1 April 2018.

(b) Introduction of Master File requirement but no clarity on its threshold

Issue

Though the Memorandum to Finance Bill, 2016 mentions about Master File requirements and provides that detailed nature of information would be required to be furnished in the Master File, detailed provisions or rules for Master File have not been prescribed. Further no threshold for preparation and filing of Master File has been prescribed.

It would be an additional burden on the taxpayers requiring investment of lot of time, efforts and resources to compile the information required in Master File (as detailed in OECD BEPS guidelines). Further without any knowledge about what would be the threshold of master file requirement, taxpayers are unable to plan their affairs in advance.

Recommendation

Draft rules should be released for public consultation (giving adequate time) detailing Master File requirements and applicable threshold, which should be considerably higher.

(c) Clarity on adoption of Local File

Issue

There is no clarity on whether the OECD recommendations on Local file would be adopted for the purpose of Indian TP regulations or not and whether there would be any threshold for the same. This would create uncertainty for taxpayers.

Recommendation

Draft rules should be released for public consultation (giving adequate time) detailing Local File requirements and applicable threshold, which should be higher than the currently prescribed threshold for TP documentation i.e. INR 1 crore.

4.26.6. Transfer Pricing Methods - Profit Split Method (PSM)

Issue

- PSM is applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction. The method involves valuation of non-routine intangible, assigning the combined profit or loss according to each party based on allocation keys and using of projected financials. Lack of clarity on valuation of intangibles and use of complex analysis for splitting the profit or loss has been experienced as the major reasons for the reluctance in using this method in India, both from a taxpayer and revenue perspective.

Recommendation

- Issuance of guidance for application of this method and valuation norms can bring about clarity to the taxpayer on usage of this method especially in light of some recent Tax Tribunal judgments accepting the use of PSM as the most appropriate method.

4.26.7. Adjustments for differences in Functions and Risks

Issues

- The Indian TP regulations provide for making reasonably accurate adjustments to take into account differences between international transactions and uncontrolled transactions, considering the specific characteristics relating thereto.
- However, in practice there is no guidance or clarity on the manner in which these adjustments are to be made. For example, adjustments in areas such as differences in levels of working capital, differences in risk profile, differences in volumes, pricing on marginal cost, start-up losses or capacity utilization and so on, have generally not been permitted by the Revenue Authorities in the course of transfer pricing audits as upheld in certain Tribunal decisions as well.

Recommendation

- Accordingly, suitable guidance on the manner of carrying out economic and risk adjustments to comparable and taxpayer's data is necessary. Further, the Revenue Authorities should be encouraged to duly consider in the course of transfer pricing audits, business strategies and commercial or economic realities such as market entry strategies, market penetration, and non-recovery of initial set-up costs, unfavorable economic conditions and other legitimate business peculiarities while determining the arm's length pricing.

4.26.8. Valuation under Customs and Transfer Pricing

Both Customs and TP require taxpayer to establish arm's length principle with respect to transactions between related parties. Objective under respective laws is to provide safeguard measures to ensure that taxable values (whether it is import value of goods or reported tax profits) are the correct values on which respective taxes are levied. The above objective, while established on a common platform has diverse end-results as seen below:

– To increase Customs duty amounts, the Customs (GATT Valuation) Cell would prefer to increase the import value of goods.

– To increase tax, the Revenue Authorities would prefer to reduce purchase price of goods.

Issues

- The diverse end-results create ambiguity in the manner in which the taxpayer should report values under the Customs and the Transfer Pricing. There are various contradicting judicial precedents which favor and contradict the use of custom valuation in transfer pricing.
- These contradicting decisions necessitate a greater need for convergence of transfer pricing mechanism under the Act and the Customs Regulations.

Recommendation

- There is a need for a common platform that would provide a 'middle-path' of arm's length price that is equally acceptable under Customs Law and under the Transfer Pricing.

4.26.9. Definition of International Transaction

Issues

Certain clauses of the explanation in the definition of "international transaction" as per section 92B of the Act override the chief machinery section for transfer pricing i.e. section 92(1) of the Act.

- Clause (c) of the Explanation (Capital financing) - The current language seems to cover transactions such as issue of shares, borrowing or lending transactions (principle loan amount) under its ambit. However, these transactions do not have any impact on the profit and loss account of the taxpayers and hence lead to unnecessary compliance burden in respect of these transactions as well as the potential exposure to penalty in case of non-compliance.
- Clause (e) of the Explanation (Business restructuring) – The current clause covers transactions of business restructuring, irrespective of the fact that it has a bearing on the profit, income, losses or assets.

Recommendations

- The definitions are contrary to the provisions of Section 92 of the Act and hence should be deleted/modified accordingly.
- The words "irrespective of the fact that it has a bearing on the profit, income, losses or assets" need modification or deletion as they are contrary to provisions of section 92(1) and section 92B of the Act.
- Further, the Act does not define what is meant by "business restructuring or reorganization". A clear definition may be included (in Section 92F) so as to provide clarity to the taxpayers/tax authorities to avoid any undue litigation on the topic.

4.26.10. Deemed International Transaction

Issue

The provision of section 92B(2) of the Act provide for applicability of TP regulations to transactions between a taxpayer and third parties (whether in India or outside India) in case where (1) there is a prior agreement in relation to the relevant transaction between such third parties and the AE of the taxpayer; or (2) the terms of the transaction are determined in substance between the AE of the taxpayer and such third party. The language of this provision leaves a lot of room for interpretation, which may lead to unnecessary litigation in future.

Recommendation

Clarification should be provided to illustrate cases which could be covered by the phrase "terms of the transaction are determined in substance between such other person and the associated enterprise.

4.26.11. Tolerance Band – Second proviso to Section 92C(2) of the Act

Issue

By Finance Act 2012, the Government notified that the flexibility of the range as was provided in the second proviso to Section 92C(2) cannot exceed 3 percent.

The tolerance band of 3% as provided for in the second proviso to section 92C(2) of the Act (1% for wholesalers as provided for vide the notification) appears to be extremely restrictive and rigid.

In case where the arithmetic mean is adopted to compute the arm's length price, the availability of a tolerance band as provided in the second proviso to Section 92C(2) should continue to be granted to the taxpayer (as an alternative to adopting the identified range as introduced in Finance (No 2) Act 2014).

Further, limiting the tolerance band to 3% (1% for wholesalers) tends to be extremely restrictive, thereby requiring the taxpayers to be extremely rigid with their pricing which may not be commercially feasible.

Recommendation

It is recommended that the tolerance band should be restored to the earlier limit of 5%.

4.26.12. Computation of Arm's Length Price

CBDT notified the final rules for using the range concept and multiple year data in determination of ALP. The rules need suitable modifications to align the same with internationally accepted arm's length standards. It is recommended that the following modifications in the rules be made:-

Issues

- The concept of range will not be applicable in cases where the most appropriate method is selected to be the profit split method or 'the other method'.
- A minimum of six comparables would be required in the dataset for applying the concept of range. There is no such requirement internationally.
- The current rules provide for a possibility of change in ALP basis from "arithmetic mean" to "range" and vice-versa, in the transfer pricing documentation vis-à-vis during transfer pricing assessment proceedings.
- An arm's length range beginning from the thirty- fifth percentile of the dataset (arranged in ascending order) and ending on the sixty-fifth percentile will be considered.
- Using financial data of comparable companies which was not available in the public domain on or before the due date for filing return but which becomes available subsequently by the time of audit can be used for determining the arm's length price. This approach should not be used for determining the arm's length price as it does not provide the much needed certainty to the taxpayer at the time of filing the tax return and will go against the spirit of contemporaneous documentation requirement under the Indian transfer pricing regulations and would increase the litigation.
- There is ambiguity on the application of range concept by APA/Competent Authorities during proceedings for APA/Mutual Agreement Procedure ('MAP').

Recommendations

- Provide applicability of "range" concept to all TP methods (including Profit Split Method).
- It is recommended to remove the requirement for minimum of 6 comparables for applicability of "range" concept for determining ALP.

- It is recommended to remove the concept of "arithmetic mean" for determination of ALP by completely shifting to "range" concept.
- Prescribe use of "Inter-quartile range" (i.e. 25th to 75th percentile) as against 35th to 65th percentile currently prescribed.
- Clarification be provided on the application of range concept by APA/Competent Authorities during proceedings for APA/Mutual Agreement Procedure ('MAP') to avoid any element of ambiguity.

4.26.13. Safe Harbour

The Safe Harbour Rules (SHR) have been introduced in India since 2013. However the Safe Harbor regime has not seen a very positive response from the taxpayers, due to various reasons, hence there are certain changes that need to be made to the SHRs.

Safe Harbour has been introduced for Software development Services (IT services), ITES, Knowledge Process Outsourcing Services (KPO services), Contract Research and Development (Contract R&D) relating to IT services and generic pharmaceuticals, for manufacture and export of core and non-core automobile components and for financial transactions like loan and guarantees.

4.26.14. KPO Services and Contract R&D Services - Issues and Recommendations

- Cost plus margins proposed are too high and above the taxpayer's expectations - The Safe harbour ratio of 25% in the case of KPO services seems to be in a higher range. A downward reduction in the currently prescribed rates would encourage more taxpayers to opt for the Safe harbour regime.
- Clarity required in categorization (e.g. for ITES v/s KPO and for IT services v/s Contract R&D relating to IT) – Contrary to industry expectations, the categorization between ITES and KPO services and IT services and contract R&D relating to software development has not been done away with. The definitions of various eligible international transactions, including that of the ITES and KPO and IT services and contract R&D services relating to software development, as provided in the SHRs leave lot of room for subjective interpretations and consequent controversies/disputes on categorization of services.
- Moreover, the provisions in the SHRs relating to tax officer's review of taxpayer's continued eligibility in subsequent AYs also add to the uncertainty on categorization of services and eligibility for the Safe Harbour.
- The rules have artificially segregated IT services into software and contract R&D services and IT-enabled services into Business Process Outsourcing ('BPO') services and KPO service. The industry feels that this complicates the matter as many of the activities may be overlapping and compliance would require a more technical analysis than envisaged in the rules. It is recommended that additional/ clear criterions are introduced for classification of services. In any case, if such classification is made, it should not be merely based on the nature of services provided and there should be certain other criteria to determine the classification e.g. value of outcome of the activity performed vis-à-vis the ultimate customer etc.

4.26.15. Advancing of Intra-Group Loans – Issues and Recommendations

- The credit rating of the borrower is one of the prime considerations for any loan transaction and this has also been duly recognized by the Rangachary Committee (RC) report by recommending different interest rates (for loans above INR 50 crores) for High, Medium, Low and Junk category of borrowers.
- Adoption of 30th June as the date for establishing Base Rate - Considering the dynamic nature of the financial market, the interest rate prevailing as on the date on which loan is granted is of prime importance. Accordingly, interest rate closest to the date of lending, as may be available, should be adopted.

- Benchmarking interest rate year on year – Typically, the interest rate should be fixed at the time of entering into the loan arrangement. It should be eligible for Safe Harbour throughout the term of the loan and not just the AYs opted for by the taxpayer for Safe Harbour (valid maximum up to a period of 5 years starting with AY 2013-14 during which SHR are applicable).

4.26.16. Providing Intra-Group Guarantees – Issues and Recommendations

- Downward revision of proposed Safe Harbour rate for guarantee commission/ fees: The rate of 2/ 1.75% in the case of guarantees below and above INR 100 crores respectively is on the higher side. In many cases the guarantee fee charged by banks could be much lesser.
- The credit rating of the borrower is one of the prime considerations for any guarantee transaction and this has also been duly recognized by the RC report by recommending different interest rates (for loans above INR 100 crores) for High, Medium, Low and Junk category of borrowers.
- The above SHRs may not necessarily cover Wholly Owned Subsidiaries. It should cover transactions with all AEs.

4.26.17. General Issues and Recommendations

- Requirement for contemporaneous documentation will continue to apply in its entirety even in case a taxpayer has opted for SHR - Accordingly, the basic objective of simplicity and easy compliance is not being met by the SHR provisions. However, the RC report has recommended that the taxpayers opting for Safe Harbour should be required to maintain only basic documentation like the details of international transaction, shareholding structure, nature of business and industry and functional analysis. It is therefore recommended that the SHR be amended to provide that the taxpayers opting for Safe Harbour should be exempted from all the documentation requirements and should be required to maintain only basic documentation as recommended by the RC.
- The margins prescribed under the Safe Harbour rules are very high and do not reflect industry benchmarks. The Government must re-evaluate these in the light of current economic environment and the fact that continued insistence on such high margins erodes competitiveness of Indian service providers and results in shifting work out of India.
- Safe harbor rules do not provide protection against double taxation. The taxpayer stands the risk of facing double taxation if the resident country of the taxpayer does not accept the safe harbor norms of India. MAP should be available for taxpayers who opt for Safe Harbour, as recommended by the OECD. This would greatly increase the attractiveness of the framework.
- Currently, SHRs have been notified in case of specified domestic transactions of government owned electricity companies prescribing limited documentation requirements for such companies. It is recommended that more such industries should be covered for simplified documentation.

4.26.18. Specified Domestic Transaction

'Specified Domestic Transactions' are covered in the scope of Transfer Pricing provisions if the aggregate amount of all such transactions entered by the taxpayer in the previous year exceeds INR 20 crores (w.e.f FY 2015-16, before that it was INR 5 crores)

Issues

- The term 'specified domestic transaction' has been defined to inter alia mean any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of Section 40A of the Act. Such expenditure could possibly include capital expenditure made to such a related person. It should therefore be clarified that these provisions pertain to revenue expenditure only.

- This amendment also covers a scenario wherein the payment of remuneration by the company to its director or relative of such directors is also required to be at arm's length. The same casts an onerous responsibility on the company vis - à- vis justification of the arm's length nature of such payments.
- Currently, there are no provisions relating to corresponding adjustment in transfer pricing regulations in respect to specified domestic transactions. It is important that if any adjustment [upward or downward] is made under the domestic transfer pricing provisions, then corresponding adjustment in the hands of the other party should be invariably be made.
- Presently, three different Sections of the Act prescribe varying thresholds for determination of 'related party' which are as under:-
  - Substantial Interest – Not less than 20% of voting power – Explanation to Section 40A(2)
  - Associated Enterprises - Not less than 26% of voting power- Section 92A(2)(a) & (b)
  - Associated Person - Not less than 26% of voting power - Section 80A read with Section 35AD(8)

Recommendations

- Necessary guidance for benchmarking directors' remuneration should be provided, as by the nature itself these could be very peculiar transactions depending on the extent of ownership, technical ability, seniority etc.
- This amendment seeks to cover a situation wherein there could not be any loss to the exchequer. The same is not in line with the suggestion provided by the Supreme Court in the case of Glaxo Smithkline. The Supreme Court had provided the situation wherein transfer pricing should be applicable in case of transactions between a profit making and a loss unit/company. The other scenario which was envisaged by the Supreme Court was transactions between units/taxpayers having different tax rates. Other than the scenarios contemplated above, a corresponding adjustment should be allowed and hence provided for in the statue.
- It should be suitably clarified that the transfer pricing provisions would only apply to revenue expenditure referred to in Section 40A(2)(a) of the Act, and not to payments made to persons specified in Section 40A(2)(b) of the Act.
- Necessary amendments should be made in the domestic transfer pricing provisions to provide for the corresponding adjustments.
- It is suggested that the threshold for determination of 'related party' prescribed in the aforesaid sections should be harmonized and necessary amendments in this regard should be carried out.
- The words "*close connection*" appearing in Section 80-IA(10) of the Act needs to be clarified to avoid ambiguity in the application of provisions of Section 92BA of the Act.
- Further, clarity should be provided with regard to inter-unit allocation of costs between eligible and non-eligible units i.e. whether corporate cost allocations from a non-tax holiday unit of a company to a tax holiday unit of the same company would get covered within the provisions of Section 80-IA(8) and consequently need to be reported as a specified domestic transaction.

4.26.19. Rollback of APA

CBDT introduced the rollback rules under the APA program on 14 March 2015. There were some ambiguities about the implementation of the rollback rules, and therefore, CBDT issued FAQs clarifying certain issues. In this regard, some of the aspects that need to be further addressed are as under:-

Issues

- The international transaction proposed to be covered under the rollback is to be the same as covered under the main APA. The term 'same international transaction' implies that the transaction in the rollback year has to be of the same nature and undertaken with the same AEs, as proposed to be undertaken in the future years and in respect of which APA has been reached.
- The rules provide that if the applicant does not carry out any actions prescribed for any of the rollback years, the entire APA shall be cancelled.
- Clarity is required on whether an applicant would be given relief from penalties/interest arising from a higher than actual return agreed in the APA for roll back years. For example, if the applicant has actually earned returns of say 15% in roll back years, and has agreed a higher return of say 20% vide the APA roll back provisions – then, clarity would be required on whether in cases, penalties/interest would be levied/charged in respect of the additional tax liability arising on account of the higher than actual return.

Recommendations

- It is recommended that this provision should be relaxed to the extent that the taxpayers with similar transactions with no substantial changes in the functional, asset and risk profile should be allowed to take benefit of this provision. Further, if the same/similar transaction is undertaken with another AE, the benefit of rollback should be provided.

  Thus, it is recommended that the provision should be made applicable to similar nature of transactions and with different AEs.
- It is recommended that this provision should be relaxed and should not result in the cancellation of the entire APA.
- Clarification should be provided that penalty and interest will not be levied in case margins of international transaction negotiated under the APA is different/higher vis-à-vis the price of the international transaction in the previous years as reflected in the transfer pricing documentation.

4.26.20. Advance Pricing Agreements ('APA') and Mutual Agreement Procedure ('MAP')

Issue

- No bilateral APA is allowed for settling transfer pricing disputes in the absence of Article 9(2) in certain DTAAs for allowing corresponding transfer pricing relief in the host country (e.g. Germany, France, Singapore).

Recommendation

- A taxpayer should be allowed to file a bilateral APA even in cases where Article 9(2) [corresponding adjustment] is not provided for in the DTAA with a treaty partner. This is an internationally accepted principle and should be allowed for taxpayers in India as well. Otherwise India should renegotiate its treaties to include Article 9(2). Such enablement would be a huge relief for taxpayers.

4.26.21. Provide Guidance on Selection of Comparables during Assessment Proceedings

Issue

- There is no guidance on economic analysis, comparability factors etc. leading to significant dispute in search process and protracted appellate proceedings.

Recommendation

- There needs to be clear guidance on screening filters to be used for selection of comparable companies to ensure consistent use by the taxpayers and tax authorities.

4.26.22. Filing of Form 3CEB by Foreign Companies

Issue

The foreign companies are required to file Transfer Pricing report in Form 3CEB in India, even if income subject to an international transaction is not chargeable to tax in India or where the transaction entered with the foreign entity is already reported by the Indian entity in its Form 3CEB as per the provisions of the existing Indian transfer pricing law. It may be noted that, in principle, the foreign residents not having a permanent establishment in India should not be required to file Transfer Pricing report (Form 3CEB) in India keeping in view the compliances done by the Indian entity.

Recommendation

It is suggested that the Government should clear the ambiguity surrounding this issue by clarifying that the provisions of Indian transfer pricing would not apply to foreign companies/foreign residents unless they have a permanent establishment in India.

4.26.23. Use of Secret Comparables

Issue

The transfer pricing officers use secret comparables to determine the Arm's Length Price (ALP) of the transaction entered into by the taxpayer during the course of transfer pricing assessments. This is against the principles of natural justice and result in unjustifiable adjustments made to the income of the taxpayer.

Recommendation

Adequate safeguards are necessary to protect confidential information relating to the taxpayer. Also use of secret comparables should not be permitted as they do not give a level playing field to taxpayers.

4.26.24. Penalty for failure to keep and maintain Information and Document etc.

Issue

- The Finance Act, 2012 has substituted Section 271AA with effect from 1st July 2012 which reads as under:-

  "271AA. Without prejudice to the provisions of Section 271 or Section 271BA, if any person in respect of an international transaction or specified domestic transaction-

  i. fails to keep and maintain any such information and document as required by sub-Section (1) or sub-Section (2) of Section 92D;

  ii. fails to report such transaction which he is required to do so; or

  iii. maintains or furnishes an incorrect information or document, the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of each international transaction or specified domestic transaction entered into by such person."

  While the quantum of addition itself is disputable in transfer pricing assessments, fixing the penalty on the assessed income would increase the burden of the taxpayer considerably.

  Due to retrospective extension of scope of international transaction, the tax officer or Commissioner (Appeals) can ask the taxpayer to pay penalty under the said Section 271AA @ 2% of value of international transaction due

to failure to keep information in addition to another 2% under Section 271G for not furnishing the information besides regular penalty under Section 271(1)(c) of the Act. This would result in multiple tax demand on arbitrary values.

Recommendation

- It is, therefore, suggested that penalty should be restricted to tax in dispute and not linked to the value of transaction.

Issue

- While the Finance Act, 2014, extended the power to levy penalty under Section 271G to the TPO for failure to furnish information/ TP documentation, which was earlier restricted to tax officer or the Commissioner (Appeals), interestingly, there has been no amendment to Section 271AA (which prescribes the power to levy penalty for failure to keep and maintain information and document, etc. in respect of certain transactions), currently provided only to the tax officer or the Commissioner (Appeals), possibly seeking to limit powers to levy penalty for matters relating to non-compliance with statutory provisions, only to tax officers/ Commissioner (Appeals), while extending powers to levy penalty to TPOs for matters relating to proceedings in the course of conduct of TP audits.

Recommendation

- Considering that clause (iii) to Section 271AA also states that penalty shall be levied for maintaining or "furnishing" incorrect information or document, as the act of "furnishing" is typically associated with a TP audit proceedings, it is recommended that there should be some consistency on this front.

4.27. Financial Services

4.27.1. Income Characterization – Capital Gains vs. Business Income

Issue

- The Finance Act 2014 amended the definition of capital asset under Section 2(14) of the Act to include securities held by Foreign Portfolio Investors ('FPI')/Foreign Institutional Investors ('FII'). Therefore, the gains earned by FPIs/ FIIs from securities transactions are characterized as capital gains. It may be noted that Alternative Investment Funds ('AIFs'), Venture Capital Funds ('VCFs') and Foreign Venture Capital Investors ('FVCIs') make and hold investments in portfolio companies with an objective of long term capital appreciation. At times, depending on the capital needs of the promoters and the philosophy/investment strategy of the AIFs/VCF/FVCI, they may end up acquiring stakes which may be in excess of 20% and may even exceed 51%. Notwithstanding their stake in the investee companies, the objective of the AIFs/VCF/FVCI is to merely provide the financial capital to the investee companies.

Recommendation

- Therefore, the income arising from transfer of securities held by AIFs/VCFs/FVCIs be clearly spelled out to be capital gains The provisions of the Act should be suitably amended to explicitly provide that income from sale of investments by AIFs/VCFs/FVCIs would be treated as 'capital gains'. This will provide much needed clarity and mitigate avoidable litigation with the tax authorities on characterisation issues.

4.27.2. Taxation of Alternative Investment Funds

(a) Withholding Tax on exempt Income of AIF to Investors

Issue

Section 194LLB of the Act provides for tax deduction at source at the rate of 10% by the investment fund in respect of any income credited or paid by the investment fund to its investor, provided that no deduction is to be made where the payee is a non-resident in respect of any income that is not chargeable to tax under the provisions of the Act. However, in the hands of resident investor, tax withholding by the investment fund on exempt income lead to deferment of realisation of income/gains for the investors as they will need to claim the tax withheld in their respective income-tax returns as refunds. This causes needless burden on the resident investors.

Recommendation

It is recommended that section 194LLB of the Act be amended to provide for non-withholding on payment of income by the AIFs to its resident investors if the income is exempt from tax similar to the exemption provided for non-resident investors.

(b) Extension of Tax pass through to Category III Alternative Investment Funds ('AIFs')

Issue

AIFs are vehicles set-up to pool investments from various investors and to invest across different asset classes using different investment strategies. In real terms, the income that is sought to be taxed is the income of the investors. The taxation of an income, or the taxpayer itself, should not change, merely because an investor decides to use a professional asset manager to make investment decisions for him vis-à-vis directly making those investment decisions. Further, the manner of taxation should not also change, where an investor invests in an AIF instead of investing in his own name using a SEBI registered portfolio manager. The tax rules applicable to 'investment funds' in Chapter XII-FB of the Act should be extended to close ended Category III AIFs with suitable modifications to eliminate the distinction between the tax treatment of business income and income under other heads of income in the hands of the AIF/its investors.

Recommendation

Category III AIFs introduced a product that was hitherto not available in the Indian financial sector. A clear tax code for taxation of such AIFs based on the pass through tax principle will be critical for the success of this product in the medium to long-term.

(c) Pass-through Tax status should be extended to Net Losses at AIF level to the Investor

Issue

Under the AIF Regulations, Category I and II AIFs are close ended funds and the tenure of a specific fund/scheme is determined at the time of its launch. Typically, an AIF's tenure would not exceed 10 years from its launch. Based on the provisions, where the Category I and II AIF incur net losses on its investments towards the end of its lifecycle or has unabsorbed losses which cannot be utilised by the AIF, such losses would lapse. The investors would in this scenario be taxed on an amount that would be greater than the "real" taxable income derived by them from their investment in the AIF causing the AIF alternative becoming unattractive to an investor vis-a-vis direct investments.

Recommendation

It is recommended that section 115UB of the Act be amended to provide that net losses incurred by AIFs under any head of income, should also be allowed to be passed on to the investors.

(d) Exemption to AIFs from Section 56(2)(viia) and Section 56(2)(viib)

Issue

Section 56(2)(viia) of the Act provides that where shares are purchased at a value lower than Fair Market Value (FMV) of a company not being a company in which public are substantially interested, then the difference is taxed in the hands of the purchaser. Section 56(2)(viib) of the Act provides that company not being a company in which public are substantially interested, issues shares at a consideration which exceeds the fair market value of such company, then the difference is taxed as income in the hands of the issuing company.

Currently, these provisions apply to AIFs when they purchases shares of a closely held company or to the investee company when they subscribe to shares of such company.

Presently, section 56(2)(viib) of the Act provides specific exemption for companies where the consideration for issue of shares is received from inter alia Venture Capital Funds (VCFs) and Category I AIF – subcategory VCFs. Further, while such an exclusion has been provided to VCFs in respect of section 56(2)(viib) of the Act, these benefits have not been extended to section 56(2)(viia) of the Act.

Further, AIFs, being institutional investors, hold a fiduciary responsibility to invest in transactions on an arm's length basis and given that they are subject to SEBI oversight and have investor reporting obligations, it would be reasonable to assume that the price for acquisition/subscription is determined on a sound basis considering all factors associated with the investee companies and sectors past performance and future potential.

Recommendation

It is recommended that Category I AIF and Category II AIFs and their investee companies should be made exempt from the rigor of sections 56(2)(viia) and 56(2)(viib) of the Act.

(e) Remove Tax compliance of Filing Annual Return for Foreign Investors in AIF

Issue

The Finance Act, 2016 has amended section 194LBB of the Act to provide that in case of non-resident investors in Category I and II AIFs, the tax withholding will be at the rates in force i.e. at tax rates as per the provisions of the Act or the applicable Double Tax Avoidance Agreements (DTAA), whichever is more beneficial to the investor. As a result of this amendment, in case of a non-resident investor in an AIF, the entire tax liability of such investor will be deducted at source by the AIF on accrual/ distribution and, there would be no additional tax payable by such investor in India on account of its investment in the AIF.

Despite the fact that the entire tax liability of non-resident investors in the AIF will be deducted at source by the AIF, such investors are still required to obtain a Permanent Account Number (PAN) and file a return of income in India. This additional compliance will discourage several non-resident investors from making direct investments in India and thereby, diluting the effectiveness of the aforesaid policy initiative.

Recommendation

In order to encourage the growth of AIF as an asset class and to attract more foreign investment directly through the AIF route, it is recommended that where a foreign investor's only source of income in India is from investment in an AIF, and, the entire tax liability of such investors is deducted at source by the AIF on accrual/ distribution, then, the requirement to file a return of income by such a non-resident investor should be eliminated. This is similar to the relaxation provided in section 115A of the Act to non-resident investors earning certain prescribed income on which tax deductible at source has been deducted.

4.27.3. Safe Harbour provisions for Fund Managers present in India

In order to encourage fund managers to shift their base to India and mitigate concerns of adverse tax consequences in making this shift, the Finance Act, 2015 has clarified that management of overseas funds by fund managers in India shall not create a business connection of the overseas funds in India subject to certain prescribed conditions. The Finance Act, 2015 has prescribed various conditions to be fulfilled to become an 'eligible investment fund' (EIF) and an 'eligible fund manager' (EFM) through an insertion of a new section 9A to the Act. While the language in Section 9A(1) of the Act provides that fund management activity for an EIF shall not constitute 'business connection', the same does not specify that the presence of the fund manager will not cause the EIF to constitute its PE in India, where the EIF is eligible for and claims taxation in India in accordance with the provisions of a tax treaty. It is recommended to specifically provide in the Act that fund management activity carried out through an EFM acting on behalf of an EIF shall not constitute a Permanent Establishment [as defined in section 92F(iiia) or in agreement referred in section 90(1) has been entered into] in India of the said fund.

However, there are certain stringent conditions which restricts the funds to qualify as 'eligible investment fund' and fund manager to qualify as 'eligible fund manager' which need to be relaxed to provide the intended benefit of the section to overseas fund:

Section 9A(3)(c)

Issue

To qualify as an EIF, the aggregate participation or investment in the fund, directly or indirectly, by persons resident in India does not exceed 5% of the corpus of the fund. In the guidelines, it is stated that where the direct investor in the fund is the Government/Central Bank/Sovereign Fund/multilateral agency/appropriately regulated investor, the fund is required to obtain a written declaration from the direct investor regarding participation by resident Indians. In case of all other direct investors (who are not natural persons), the fund is required to undertake appropriate due diligence to ascertain indirect participation by resident Indians in such a fund. In any case, the Government should have access to those investors or investment platforms investing in EIFs under the applicable DTAAs or Tax Information Exchange Agreement.

It would be difficult and a cumbersome process for the fund to undertake appropriate due diligence to ascertain the indirect participation by Indian resident. Further, requiring confirmation of indirect participation of resident investors would be extremely impractical and impossible for the fund/ fund manager.

Recommendation

Section 9A(3)(c) be amended to provide that as long as aggregate participation in the fund by the immediate investor (being resident Indian) is not more than 5% of the corpus of the fund, it should suffice for the purpose of compliance with the condition.

Further, Rule 10V(2) should be deleted.

Issues

To qualify as an EIF, following conditions are required to be fulfilled:-

Under section 9(A)(3) reference is drawn to clause (e), (f) and (g):-

- Clause (e) - The fund has a minimum of 25 members who are, directly or indirectly, not connected persons.
- Clause (f) - Any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%.

- Clause(g) - The aggregate participation interest, directly or indirectly, of 10 or less members along with their connected persons in the fund, shall be less than 50%.

Issues

The Guidelines provide for looking through specific entities (subject to conditions). The existing regulatory framework allows foreign investors to investment under the SEBI (Foreign Portfolio Investors (FPI)) Regulations, 2014 and SEBI (Foreign Venture Capital Investors (FVCI)) Regulations, 2000. Further, there are many instances where the fund managers wish to manage a small set of investors where such investors could provide them with relatively large pools of capital to manage. While the guidelines are helpful, the look through provision is restrictively worded since it suggests that only one level look through is permitted.

Recommendations

- Section 9A(3)(e), (f) and (g) be amended to provide that these conditions should not be applicable to SEBI registered FPIs/ FVCIs.
- In determining number of members, look through approach be permitted. The term 'member' should be interpreted in a manner to include investors and beneficiaries.
- The minimum members in the fund should be reduced to 10 from 25.
- The threshold of 10% prescribed for participation interest of the member along with the connected persons in the fund should be increased to 49%.
- The threshold of 50% or less prescribed for participation interest of 10 or less members along with the connected persons in the fund should be deleted.
- A new clause should be inserted to provide that the fund is a broad based fund as defined in the SEBI FPI Regulations.

Section 9A(3)(h) of the Act

Issue

To qualify as an EIF, the fund shall not invest more than 20% of its corpus in any entity.

Where the offshore fund is not an India focused fund, there could be situations where the fund invests more than 20% of its corpus in an entity outside India because the regulatory regime in those countries permits such investments.

Given that one of the focus of VCPE funds is to invest in early stage – growth stage companies, there may be follow-on investment opportunities in well performing portfolio companies. The aforesaid condition could then become a limiting factor for the fund to be able to participate in such follow-on investments.

Recommendation

Section 9A(3)(h) be amended to provide that EIF shall not invest more than 20% of its corpus in any Indian entity. Further, the restriction on investing more than 20% of an EIF's corpus should be determined at the first instance when the fund commits capital to a portfolio company. Any follow-on investments in a portfolio company at a later stage should not by itself disqualify the EIF from the benefits of the safe harbour provisions.

Section 9A(3)(j) of the Act

Issue

To qualify as an EIF, the monthly average of the corpus of the fund shall not be less than 100 crore rupees. Provided that if the fund has been established or incorporated in the previous year, the corpus of fund shall not be less than 100 crore

rupees at the end of such previous year. Where the offshore fund is a newly set up fund, (particularly, if the fund is set up closer to March 31) it may be difficult for such fund to have a monthly average corpus of more than Rs 100 crores in year 1. Further, in case of open ended fund, inclusion of committed capital in determining the corpus of the fund, shall not serve the purpose, since such funds do not lay down a target committed capital.

Recommendation

Section 9A(3)(j) be amended to provide that if the fund has been established or incorporated in the previous year, corpus of fund shall not be less than 100 crore rupees at the end of such previous year or 24 months from the date of establishment or incorporation of the fund. Similarly, when the fund is winding down this condition should be relaxed in the last year. Further, the term 'corpus' should be interpreted to mean 'commitments raised' rather than funds received.

Section 9A(3)(k) of the Act

Issue

To qualify as an EIF, the fund shall not carry on or control and manage, directly or indirectly, any business in India. In the guidelines notified for application of section 9A, it has been stated that a fund shall be said to be controlling or managing a business carried out by any entity, if the fund directly or indirectly holds more than 26% of the share capital or voting rights or interest in the entity.

Funds may occasionally or as their core strategy take minority, significant minority or majority stakes in investee companies. Several funds adopt a combination of strategies. At times, VCPE funds (especially buyout funds) acquire a controlling stake in the investee companies without any intention of actively controlling or managing its business. Also, in a scenario, where the foreign investors invest by way of compulsory convertible instruments, pursuant to the conversion of these instruments, these investors will end up holding more than 26% of the shareholding in the said entity without any change by it in the control or management of business in India or from India.

The intention of restricting section 9A to only diversified funds and not to strategic foreign investors or Indian companies indirectly is achieved through the diversification of shareholding requirements in clauses (e), (f), (g) and indirect Indian shareholding restriction in clause (c).

Recommendation

In order to promote the safe harbour for VCPE funds, it is recommended to delete clause (k) of sub-section 3 to section 9A of the Act and sub-Rule 4 of Rule 10V, as a qualification condition to avail section 9A.

Section 9A(3)(m) of the Act

Issue

To qualify as an EIF, the remuneration paid by the fund to an EFM in respect of fund management activity undertaken by him on its behalf is not less than the arm's length price of the said activity.

- Ordinarily where the EIF and the EFM are unrelated or unconnected, there is no reason to believe that the fund management fees will not be at arm's length. In cases, where they are related or connected persons (or put it differently, associated enterprises), the payment of fund management fees to the EFM has to be computed at arm's length.
- A determination of fees being in accordance with an arm's length principle could involve a lot of subjectivity (factors to be considered include demand and supply, experience and track record of the EFM, investment strategy etc.) and it is possible that the tax payers and tax authorities have a different point of view on what constitutes an arm's length price. Any challenge by the tax authority could result in an uncertainty on the tax liability of EIFs on account of risk of them being regarded as resident in India or carrying on operations in India.

Recommendation

Section 9A(3)(m) to be amended to provide that it shall not apply to cases where the EFM and EIF are unrelated parties as well as situations where provisions relating to transfer pricing under the Act are applicable.

Section 9A(4)(b) of the Act

Issue

To qualify as an EFM, the person who is engaged in the activity of fund management is registered as a fund manager or an investment advisor in accordance with the specified regulations.

The definition of specified regulations does not cover SEBI registered asset managers to mutual funds.

Recommendation

Section 9A(9)(e) be amended to include SEBI (Mutual Funds) Regulations, 1996 as specified regulations.

It also needs to be clarified that the management of all or part of the activities of the FPIs in India would not result in the FPIs being regarded as being "resident" in India as per Section 2(42) read with Section 6 of the Act.

4.27.4. Issue of shares at a value higher than Fair Market Value to VCF/ VCC - Section 56(2)

Issues

- Though Finance Act 2012 specifically carved out sub category VCF under Category I AIF from the provisions of Section 56(2)(viib) of the Act, certain unintended consequences as stated below have arisen which impact the VC industry at large. The industry being tightly regulated by SEBI is facing certain unintended consequences which include:
  - Certain unintended transactions (for e.g.; – capital reserve arising pursuant to merger) may also get covered within the purview of Section 56(2)(viib) of the Act, which is not desirable.
  - It is quite common for VC investors to enter into "ratchet structures" with the issuer company/promoter wherein convertibles are issued and conversion price is formula based and linked to the company's performance, adjustment of shareholding percentage etc. In certain scenarios, such ratchet could result in the company issuing shares to parties (other than VCF/ VCC) at high premium attracting tax implications in the hands of the issuer company under the above amendment. Thus, the provisions of section 56(2)(viib) of the Act could adversely affect bona fide, arm's length ratchet structures agreed with resident promoters/ other investors wherein they are required to infuse funds or convert at a substantial premium for the adjustment of shareholding.
- The above provision may also hinder the ability of investee companies to make genuine arm's length inorganic acquisitions.
- Exclusion under Section 56(2)(viib) of the Act should apply to shares issued to all Category I and II AIFs and not only to the sub category "venture capital fund".
- It is also noted that despite the fact that the above provisions have been introduced for shares issued from April 01, 2012 onwards, VCUs are being issued with tax demands on premium received prior to April 01, 2012. This causes an unnecessary burden on portfolio companies and increases their litigation and compliance costs. Accordingly, it is represented that appropriate instructions should be issued to tax officers to refrain from this practice.

- There may be instances where the company receives consideration in one tax year but issues shares in the following tax year or in certain cases does not issue shares but refunds the share application money to the shareholder, there is lack of clarity in such cases as to the year in which the provision would apply or whether the provision would apply at all.
- It would be prejudicial to subject the Issuer Company to such adverse provisions which did not exist in law when the transactions were entered into.

Recommendations

- Given that the said provision is intended to effectively be an 'anti- avoidance' provision, the following situations where no 'tax- avoidance' ought to be involved merit exclusion. Consequently:-
  - Applicability should be restricted to issue of shares in consideration for cash.
  - The issue of shares pursuant to otherwise exempt transactions such as merger, demerger, inorganic acquisitions etc. should be excluded from the purview of Section 56(2)(viib) of the Act.
  - It is recommended that it should be suitably provided for in the Section that it would apply only in the year of issue of shares.
  - It should be suitably clarified to provide that the Section does not require every closely held company that issues shares to a resident to suo-motto offer such income to tax. Further, the tax officer should be empowered to invoke this Section only if at the time of assessment, the tax officer is of the view that premium charged by the company from the resident shareholder is in excess of the fair market value of shares issued.
  - The provision should not be made applicable to bona fide ratchet structures.
  - The provision should not be made applicable to all Category I and II AIFs.
  - The provision should not be made applicable to any issuance of securities under any arrangement/ instrument/ transaction existing prior to the said amendment.
  - Specific instructions should be issued to tax officer to refrain from challenging the share premium paid by VCF to VCU on subscription of shares prior to April 1, 2012.

4.27.5. Clarification on lower TDS Rates on Corporate Bonds and Government Securities

Issues

- Rate of TDS in respect of interest earned by FIIs and Qualified Foreign Investors ('QFIs') on bonds issued by Indian companies and Government securities has been reduced from 20% (for FIIs)/ 40% (for QFIs) to 5% vide Section 194LD of the Finance Act 2013. This is a welcome change by the Government to encourage foreign debt in India. However, the benefit of reduced rate was made available only if:
  - The coupon rate on corporate bonds does not exceed the rate as notified by the Central Government; and
  - The benefit will be available in respect of interest income accruing to FIIs and QFIs between the period June 01, 2013 and 30th June 2017 irrespective of the date of investment.
- Currently, on technical reading of the provision, a FII/ QFI shall not be able to avail the benefit of the concessional tax rate if its coupon rate exceeds the notified rate of Central Government. Thus, in order to encourage foreign debt investment in India, it is represented that the benefit of reduced TDS rate shall be made available to all FIIs/ QFIs irrespective of the notified rate (i.e. the coupon rate as notified by the Government).

- Section 194D of the Act inter-alia states that the benefit is available to interest payable on "bonds" of Indian companies.

Recommendations

With the intent to encourage foreign debt investment in India by FIIs/QFIs, it is represented that:-

- Section 194LD of the Act to be amended to state that benefit of reduced TDS rate shall be available to all FIIs/ QFIs irrespective of the notified rate (i.e. the ceiling coupon rate to be notified).
- Without prejudice to above, it is represented that interest up to the notified rate be subject to beneficial rate and any incremental coupon above the notified rate be subject to normal tax rates as applicable under the Act or treaty (as opposed to the entire interest income being taxable at the normal tax rates as per the Act/ treaty).
- Language of Section 194LD may be amended to explicitly cover "debentures" in addition to bonds as well especially considering private corporate debt is typically raised through debentures.

4.27.6. Set Off of brought forward Speculative losses

The Finance Act 2014 amended the Explanation to Section 73 of Act w.e.f 1st April 2015 (ie AY 2015-16) to provide that losses of companies having principal business of trading in shares will be treated as non-speculative. Further, clause (e) has been inserted to section 43(5) of the Act w.e.f 1st April 2014 (i.e. AY 2014-15), to provide that a transaction in respect of trading in commodity derivatives carried out on a recognized association to be non-speculative.

Whilst the above amendments have been done, the Act does not prescribe any mechanism for enabling set-off of earlier brought forward speculative losses from the same business or from trading in commodity derivatives.

Both the above amendments are hindering the ability of tax payers to set-off speculative losses incurred under the erstwhile provisions of the law against the income of the same business which is now treated as non-speculative due to the amendments.

Recommendation

It is recommended that it may be clarified that brought forward speculative losses on account of the above two reasons be treated as non speculative for set-off in the current and subsequent years.

4.28. Tax Deducted at Source (TDS)

4.28.1. TDS on Monthly and Year end provision entries in Books of Accounts

Issues

- Most of the companies record provision entries towards various expenditures on a monthly basis to report performance to their parent entities. These entries are reversed in the subsequent month.
- These accruals are made on very broad estimates. The tax officers have been insisting that tax be deducted on these provisional entries.
- Year-end provisions are made by assessees to follow accrual system of accounting. Very often provision for expenses at the year-end are made based on best estimates available with the assessee even if the supporting invoice is received at the subsequent date. As per the current tax regime, tax is required to be deducted on such provisions which often leads to excess deduction and deposit of tax, disputes with the vendor and unnecessary burden posed on the payer in carrying extensive reconciliations.

Recommendation

- It is recommended that relief from deduction of tax at source should be given on payments that are accrued but are not due to the payee and for which the payees are not identifiable and represents only a provision made on a monthly basis for reporting purpose and are reversed on the first day of the subsequent month.

4.28.2. Procedural Issues on TDS - Clarification on definition of Process Royalty

Issue

- In Section 9(1)(vi) of the Act, Explanation 6 was inserted, with retrospective effect from the 1st June 1976, clarifying that the expression 'process' includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret. To avoid any confusion and interpretation issues, it should be clearly clarified that payment of telephone bills including mobile bills, payment of internet charges, payment to cable operators, service providers for viewing television channels, payment of broadband charges, electricity charges, wheeling/transmission charges etc., where the payment is only for the right to use the service without any payment for the right to use/control on the equipment/apparatus does not constitute 'royalty' under the expanded definition under section 9(1)(vi) of the Act post retrospective amendment by the Finance Act 2012.

Recommendations

- TDS should be deductible and payable only at the time of payment and not at the time of credit. This is particularly required where a bill is under dispute/reconciliation with the vendor. If TDS is made on conservative basis before payment, it provides scope for the vendor to claim that it is an acknowledged debt by the taxpayer and compromises taxpayer's position before the civil court.
- Liberalised and expeditious issue of annual NIL TDS certificates under section 197 after considering track record of TDS collection and trend of advance tax payments in the past or past 2-3 years. This will reduce TDS compliance burden on the payers.
- Introduction of scheme for monthly payment by payee of TDS-advance tax in addition to regular quarterly advance tax instalments in lieu of which payees can give declarations to payers not to deduct tax.
- General exemption under section 197A(1F) for specified class of taxpayers like scheduled banks, telecom companies, insurance companies, certain SEBI regulated companies with good tax and business record, etc.
- Introduce facility for advance deposit of TDS without specifying section no. and AY which payer may then appropriate towards deductions made under various sections on monthly basis (akin to Personal Ledger Account for Excise duty/Service Tax).
- Where there is merely characterisation dispute on TDS rate, there should be no levy of penalty neither disallowance of the entire expense.
- Deductors may be permitted to issue consolidated TDS certificates for full year instead of present system of quarterly TDS certificates.

4.28.3. TDS Credit

Section 203 of the Act requires the deductor of TDS to issue the TDS certificate to the deductee to the effect that tax has been deducted and specifying the amount so deducted. The deductor has to log in to the TDS CPC website and download the certificate of the deductee and then send such certificate to the deductee.

Issues

- Every quarter the deductor is required to login into the TDS Reconciliation Analysis and Correction Enabling System (TRACES) website and download TDS certificate for all the deductees and forward the same to each deductee. In case deductor is a big organisation which has deducted TDS for thousands of parties, it is required to send the TDS certificate through mail or post separately to each deductee. Issuing TDS certificate to thousands of parties every quarter poses challenges and also consumes lot of time which can otherwise be used for operations of the deductor. This sometimes leads to incomplete or non-compliance with issue of TDS certificates.

  It is also the deductee who suffers by way of denial of TDS credit in absence of TDS certificate and therefore it is a must for the deductee to continuously chase each deductor for issue of TDS certificate. It may be relevant to mention here that the AO's do not always give TDS credit, especially for years in the past, on basis of Form 26AS appearing in the system but require hard copies of the TDS certificates.

  The CBDT vide Circular No 3/2011 dated 13 May 2011 and Circular No 1/2012 dated 9 April 2012 has clearly demonstrated that there would not be any variation between TDS credit reflecting in Form 26AS and TDS credit as per Form 16A. Further, in addition to these circulars, the CBDT in Central Action Plan has also directed to give TDS credit on the basis of Form 26AS, thus reducing the relevance of Form 16A for the purpose of claiming TDS credit.

- A taxpayer claims credit of TDS on the basis of TDS figures reflected in Form 26AS at the time of filing the return of income. In case TDS reflected in Form 26AS is enhanced owing to reasons such as update/revision of TDS returns by tax deductor etc. and the time limit for filing the revised return has expired, the tax payer is not able to claim the enhanced credit of TDS. The enhanced credit is not allowed by the tax officer during the time of assessment proceedings since the updated figure is not claimed in the return of income of the taxpayer.

- As per the existing mechanism, TDS Certificates are generated from the web site of TRACES based on the PAN of the deductee. As a result, all the TDS certificates are getting issued at the address declared in the PAN application made by the deductee. This has resulted into severe hardship for the companies which have a multi locational set up, since, all the TDS certificates gets dumped at the Registered office of the company (being PAN based address). The accumulation of TDS certificates at the registered office of the deductee makes it difficult for them to co-relate/reconcile them with the accounts which are maintained at different locations and also the units are not able to identify whether the TDS certificate is received from the party or not. Till the time requirement to issue TDS certificates is not done away with, the address for issuance of TDS certificates be linked with the address mentioned in TAN application of the deductee.

Recommendations

- It is recommended that TDS credit should be allowed purely on the basis of Form 26AS (irrespective of the fact whether the same has been claimed in the return or not) and the procedural requirement for issue or obtaining of TDS certificate in Form 16/Form 16A should be dispensed with by making suitable amendment in the Act.

- Alternatively, deductees should be enabled to electronically download TDS certificates (Form 16/16A) from the TRACES portal instead of the current system of the tax deductor having to download Form 16/16A and sending the same to the deductee.

- Alternatively, TDS CPC website of the department be enabled to e-mail the Form 16/16A to both deductor and deductee on generation of TDS certificate by either the deductor or deductee.

- Instructions should be issued to the tax officers to the effect that the credit for TDS at the time of assessment proceedings should be based on latest Form 26AS, even if the credit is not claimed by the tax payer in the return

of income, subject to the only condition that the taxpayer had shown the corresponding income in its return of income.

- Till the time requirement to issue TDS certificates is not done away with, the E-TDS software of the tax department may be amended so that when the TDS returns are processed to generate the TDS certificates, the address for issuance of TDS certificates be linked with the address mentioned in TAN application of the deductee.

4.28.4. Issues related to Certificate under Section 195/197

Issue

In some cases, the Assessing Officers are linking the issue of lower/ no deduction certificates with outstanding demand against the assessee. These two issues are independent of each other and correlating them causes undue hardship to the assessee. Suitable instruction may be issued to the tax officers to delink the two and decide on the application for certificate under section 195/197 for lower/no deduction of tax independently based on the merits of the case.

There is currently no time limit prescribed under the Act for issuance of certificates under section 195 and section 197 of the Act. As a result, the applications may not be disposed in a time bond manner, resulting in unnecessary follow-ups and inconvenience by/for the taxpayers.

Recommendation

Suitable instruction may be issued to the tax officers to delink the two and decide on the application for certificate under section 195/197 for lower/no deduction of tax independently based on the merits of the case.

It is recommended that a suitable timeline be inserted in the Act for disposing of withholding tax applications requesting for lower/nil rate of deduction of tax.

4.28.5. Reduced Withholding Tax on Income by way of Interest under Section 194LC

In order to enable low cost finance to Indian companies, the Finance Act, 2012 has inserted Section 194LC in the Act which provides for lower withholding tax @ 5% on interest payments by Indian companies on borrowings made in foreign currency (under a loan agreement or by way of issue of long term infrastructure bonds). The Finance (No 2) Act, 2014, amended the section to include all long term bonds (including infrastructure bonds).

Issue

- Apart from loans and bonds, debentures are also widely used for raising funds by the Indian companies. Currently, there is no clarity whether interest payment on such debentures would be eligible for reduced withholding tax rate under section 194LC of the Act.

Recommendation

- The concessional tax rate of 5% on interest should be made applicable on other debt securities including debentures, trade credit issued/availed by any Indian company. Further, it is also suggested that the rate of tax on interest through all kinds of foreign currency borrowings (including issue of bonds and debentures) should be completely eliminated in the long-run to promote foreign exchange inflows into India.

4.28.6. Reduced Withholding Tax on Income by way of Interest

Issue

The benefit of concessional rate under section 194LC and section 194LD of the Act is available only if the rate of interest on the loan/bond does not exceed the rate notified by the Central Government. If rate of interest exceeds Government notified rate, benefit of concessional rate is not given on entire amount.

The concessional rate under section 194LC and 194LD is only applicable in respect of loan taken/issue of bond before July 1, 2017 and interest payable before July 1, 2017 respectively. This will damper investments from overseas in India as the interest income will be taxed at a higher rate as per the provisions of section 195 of the Act.

Recommendation

It should be clarified that only the excess interest paid over the notified/approved rate will not be eligible for the 5% tax deduction and would be liable to tax deduction under section 195.

It is recommended that the sunset clause in section 194LC and section 194LD of the Act be extended by at least three more years.

4.28.7. Clarity on TDS on Export Commission Paid to Non-Resident Agents

Issue

Central Board of Direct Taxes ('CBDT') had issued Circular no. 23 dated 23 July 1969, clarifying that commission paid to non-resident agents during the course of export was not taxable in India. Further, vide circular no. 786 dated 7 February 2000, the CBDT had again stated that, such commission paid to non-resident agents was not taxable in India under section 5(2) and 9 of the Income Tax Act, 1961 ('the Act') and no tax is therefore deductible under section 195 of the Act.

CBDT vide Circular No. 7/2009 dated 22 October, 2009 withdrew the circulars No 23 dated 23rd July, 1969, No. 163 dated 29th May, 1975 and No. 786 dated 7th February, 2000. The reason stated by CBDT in its 2009 circular was that the circular cannot be interpreted to allow relief to the taxpayer who is not in accordance with the provisions of section 9 of the Income-tax Act or with the intention behind the issue of the Circular. The 2009 circular also stated that it has been noticed that interpretation of the Circular by some of the taxpayers to claim relief is not in accordance with the provisions of section 9 of the Income-tax Act, 1961 or the intention behind the issuance of the Circular.

Even if the aforesaid Circulars have been withdrawn, the legal position with respect to the taxability of the commission paid to foreign agents has not changed in view of section 9 of the Act and judicial pronouncements are in favour of the taxpayers. The Hon'ble Supreme Court in the case of CIT v. Toshoku Limited (1980) (125 ITR 525) (SC) has held that considering the statutory provisions of the Act, the commission amounts which were earned by the non-resident for services rendered outside India cannot be deemed to be income which has either accrued or arisen in India. It was also held that the non-resident agent did not carry on any business operations in the taxable territories as contemplated by Explanation 1(a) to Section 9(1)(i) of the Act. The position has been reaffirmed by the various courts that even after the withdrawal of circular no. 23 (supra), the commission paid to non-resident is not liable to tax under the Act when the services were rendered outside India, services were used outside India, payments were made outside India and there was no business connection of the non-resident in India.

Even assuming that the non-resident agent has a business connection in India, as no operations, per se, are carried out by him in India, as per Explanation 1(a) to section 9(1)(i) of the Act, no income can be attributed in India and hence taxed in India. This principle has been affirmed by the Hon'ble Supreme Court in the case of Carborandum vs CIT (108 ITR 335) as well as in the case of Toshoku Ltd (supra).

However, by withdrawal of circular no. 23 (supra), the commission paid to non-resident agents for the purpose of export is being perceived by the tax authorities as taxable in India in virtually all the cases. The tax officers are not giving cognizance to the facts of the cases and judicial precedents relied upon by the taxpayers. Consequently, a large number of Indian companies are facing the issue of disallowance of the expense in respect of the said commission and have been served notices with huge demands for failure to deduct tax at source on the commission paid to its foreign agents.

The arbitrary disallowance of the export commission by the tax officers in the hands of the Indian company has created widespread litigation. This is gravely affecting the cash flow of the companies and is acting as a hindrance for the Indian companies to develop their market internationally.

Recommendation

It is recommended that it should be clarified that the commission payment to non-resident agents is not taxable in India if they does not fall within the purview of section 5 and section 9 of the Act. It should be further clarified that the tax withholding obligation in the hands of the payer would not arise if the commission is not chargeable to tax under the Act, irrespective of whether a specified declaration from the revenue authorities, under section 195 of the Act, has been obtained or not.

4.28.8. Deputation of Employees

- Increasing globalisation has resulted in fast growing mobilization of labour across various countries.
- Typically, the company deputing the personnel initially pays the salary and other costs on behalf of the company to which such personnel are deputed, which are thereafter reimbursed by the latter company.

Issue

The issue which had cropped up before the Indian tax authorities due to the increasing deputation agreements being entered cross border was whether such reimbursements made by Indian entity to an overseas entity towards salary and other costs in relation to the deputed employees should be taxable in India as being payment in the nature of fees for technical services.

Recommendation

- Since the employees deputed to the Indian company work under the control and supervision of the Indian company and hence are essentially 'employees' of the Indian company, the amounts paid by the Indian company to the foreign company are merely 'cost reimbursements' for the salaries paid on the Indian company's behalf.
- In order to put an end to this litigation, a specific clarification may be provided by the Government to the effect that as long as the employee reports and works directly for the Indian company and operationally works under the 'control and supervision' of the Indian company, payments made by the Indian company to the foreign company towards reimbursement of the salary cost would be treated as 'pure reimbursement' and would not be taxable under the Act.

4.28.9. Enhancement of Limits for TDS - Section 194C and others

Issues

- Under Section 194C of the Act, TDS is applicable in respect of contracts for manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. However, in a large number of instances, it is observed that the material which is purchased from the customer represents a small fraction of the total cost and this provision has created huge operating problems, since the transaction may be a 'principal–to principal' contract for purchase and sale of goods and the profit margin may be very small.
- Currently, any payment for contract services rendered which exceeds Rs. 30,000 at a time or Rs. 100,000 per annum requires the person responsible for making such payments to deduct tax at source under Section 194C of the Act.

Recommendations

- It is suggested that the provisions of Section 194C of the Act be should be applicable only in such cases where the material purchased from the customer is substantial in nature, i.e., say it exceeds 40% of the total material cost (inclusive of raw materials and packing materials).
- It is recommended that the threshold limit should be increased to Rs. 50,000 for single payment under Section 194C of the Act.
- On similar basis, considering the inflation quotient, the threshold limits for other TDS provisions should also be enhanced as follows:-

Section	Category	Enhancement requested
194A	Interest on Bank Deposits	TDS limit of existing Rs.10,000 to be increased to Rs.1.00 Lakhs since the basic exemption limit of Income increased substantially and the senior citizens are affected in this category.
194I	Payment of rent	The existing limit of Rs.1.80 Lakhs per year to be enhanced to Rs.3.00 Lakhs.
194J	Payment to Professionals	The existing limit of Rs.30,000 to be enhanced to Rs.1.00 Lakhs

4.28.10. TDS on Interest component included in Tribunal Awards to victims of Accidents

Issue

- The Revenue Authorities generally treat the amount of interest paid on delayed compensation awarded under Motor Vehicle Act, 1988 as 'interest' liable for TDS under Section 194A of the Act

Recommendation

- It is suggested that such interest be excluded from the purview of TDS under Section 194A of the Act.

4.28.11. Time limit for holding a Taxpayer to be an 'Assessee in Default' for Payments

Issues

- Section 201(3) of the Act states that no order under section 201 of the Act shall be passed holding an assessee to be in default for failure to deduct whole or part of tax from a person "resident" in India after the expiry of 7 years from the end of the financial year in which payment is made or credit is given.
- However, no such time limit exists where payment is made to a non-resident without deduction of taxes.

Recommendations

In order to provide certainty to taxpayers, it is recommended that similar time barring provisions should be introduced even in cases where payments are made to non-residents without deduction of taxes.

4.28.12. Hindrance in granting Relief provided under first proviso to Section 201(1)

Issue

As per first proviso to section 201(1) of the Act, any person who fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII of the Act on the sum paid to a resident or on the sum credited to the account of a resident shall not be deemed to be an assessee in default in respect of such tax if such resident:-

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income,

and the person furnishes a certificate to this effect from an accountant in such form as may be prescribed.

The prescribed Rule is 31ACB. As per Rule 31ACB, the certificate from the accountant as per the first proviso to sub-section (1) of Section 201 of the Act shall be furnished in Form 26A to the DGIT(Systems) or the person authorized by the DGIT(Systems) in order to avail the benefit of proviso to Section 201(1) of the Act. Till date no person has been authorized in this regard and neither any prescribed procedures, formats and standards for the purpose of verification of Form 26A has been prescribed due to which the assessee companies are not able to avail the benefit of first proviso to Section 201(1) of the Act.

Recommendation

It is recommended that the Government should issue a notification authorising a jurisdictional AO under Rule 31ACB to accept Form 26A for verification, since he can provide due relief to the assessee during the assessment proceedings.

4.28.13. Foreign Tax Credit Rules ('FTC')

CBDT vide Notification S.O. 2213(E) dated June 27, 2016 has notified the rules in relation to foreign tax credit. However, the rules does not address certain issues in relation to claim of foreign tax credit having a negative impact on outbound activities of Indian companies and are therefore, placed below for the consideration of the Government:-

(a) Aggregation/Pooling of Foreign Taxes

The rules currently require the Indian companies to calculate the credit limited to each source under a separate basket in particular country. Due to which Indian companies may not be able to fully utilize the amount of foreign taxes paid in foreign countries. In other words, if the foreign tax in one basket of income is not available to offset the taxes attributable to income in another basket that would result in higher tax burden on the resident taxpayers.

It is submitted that such an approach is extremely onerous and could pose serious practical challenges. This problem could be particularly acute in the case of Indian multinational enterprises that receive multiple sources of income from several countries.

It is also relevant to note that most countries do not contemplate a separate computation of FTC for each source of income and permit pooling of some kind. Accordingly, it is submitted that in line with international experience (particularly in countries such as the US, China, Singapore etc.) the Government should permit pooling of foreign source incomes while determining FTC. Such pooling could take the form of either of the following approaches:-

1. **Global Pooling** – Under this approach, all foreign sourced income (from all sources from all countries on an aggregate basis) can be pooled and available for set off against the Indian tax on all foreign sourced income. This approach offers significant advantages in terms of simplicity and documentation.

2. **Country-by-Country Pooling** - Under this approach, all foreign sourced income received from each country are aggregated and are set off against the Indian tax on income received from that country. Such an approach is favoured by several countries, including China, and offers a simplified approach to quantifying the FTC available against local taxes.

3. **Pooling based on Basketing of Income** - Alternatively, incomes can be basketed into two kinds – active and passive and the FTC quantification can be determined separately for each basket. Under this approach all passive income (e.g. dividends, royalties, rent, interest and capital gains) received from all countries are aggregated and set off against Indian taxes on such passive income. This basketing approach is also widely used, most notably in the United States.

- It is requested that necessary statutory changes be made to enable the pooling of foreign taxes for the purposes of availability of credit. This will help pave the way for building a robust and fair regime for FTC in India.

(b) Difference in Computational Provisions

- There could be different computational provisions under the domestic law of various countries, resulting in different taxable income. Some of these differences could well be temporary differences (say different depreciation rate or accrual versus cash system), which could result in a loss of foreign tax credit. For example, where Indian company is not able to absorb the credit of tax paid in source country in initial years since the tax liability in India is low, whereas it may be required to pay tax in India in the later year as the amount of tax credit would be less in those years. The excess foreign credit in initial years which could not be absorbed is not available for credit against the tax liability in later years. This results in additional tax cost for Indian residents. The excess foreign tax so lost due to temporary differences should be allowed to be carried forward and set-off against the Indian tax liability in the subsequent years.

- A different method of accounting (say cash method) may be followed by source country for taxability of income and accrual method may be followed by taxpayer while computing its tax liability in India. In such a situation, the income would suffer tax in source country in the year in which it is received by the taxpayer. However, by following accrual method of accounting, income would be taxed in India in year 1 against which no foreign tax credit will be allowed as the foreign taxes will not be paid in year 1 but in year 2. Hence, there is possibility that by the time, income would be received and suffer tax in the source country, the time to revise the tax return in India may have expired. In such cases it should be allowed to revise the tax return of earlier years to claim foreign tax credit. Appropriate amendment may be carried out in the statue if need be.

  Time limit for filing revised return in such cases may be extended. Alternatively, provisions similar to section 155(11A)/(14) which grants the power to the tax officer to revise the assessment based on proof submitted may be introduced.

(c) Difference in the Tax Status of Taxpayer

Certain countries treat partnership firms as fiscally transparent i.e. partners (and not the firm) are liable to pay tax while the other countries (such as India) treats the firm as taxable entity and thus, levy income tax on the firm and not partners. In such a situation, the issue arises whether the credit for taxes paid by the partners in the source country can be claimed by the firm in India.

It should be clarified that in such cases the credit of foreign taxes shall be allowed in the hands of the entity which is liable to tax in India on such income.

(d) Triangular Cases

In case the Permanent Establishment of an Indian company situated in Country A earns certain income say royalty from a third country (Country B), whether the credit for taxes paid in Country B should be allowed as credit against Indian tax liability on that income. The country A also allows the credit for taxes paid in country B.

It is recommended that a mechanism may be provided in the Indian Income Tax law to provide that the foreign tax paid in Country A as well in Country B would be available against India tax.

(e) Underlying Tax Credit

The rules have not provided for availability of underlying tax credit for taxes paid overseas by the subsidiary of the Indian company. This would adversely impact post tax cash flow of the Indian companies bidding in the international markets. In order to make the bids in the international market more competitive, the underlying tax credit should be allowed to Indian companies.

It may be clarified that the taxes paid by the subsidiaries of Indian companies in foreign countries on their profits would also be eligible for foreign tax credit in India. Appropriate amendment may be carried out in the statue if need be.

(f) Taxes not covered by Treaty

If all the taxes (which are computed on income) are not covered by the treaty, it should be clarified that the credit of the same would be governed by the provisions of the domestic law of country to include taxes paid to state, cities, cantonment etc. Appropriate amendment may be carried out in the statue if need be.

Domestic law of several countries viz. Australia, Canada, France, Japan, UK, USA etc. also allow income tax paid to states, cities provinces, local authorities, territories, municipalities, cantons, communes and local governments to be claimed as credit.

(g) Tax Sparing Credits

- Many treaties signed by India provide for tax sparing clauses under which India will give a deemed credit for taxes on exempt income in the source country. The Rules do not deal with such instances.
- It is therefore submitted that with a view to avoiding potential issues surrounding the determination of the credit in absence of actual taxes paid abroad, it should be expressly clarified that credit should be available based on a certificate of an accountant in such cases.

(h) Withholding of Taxes

Section 192 relating to TDS on salary needs to be amended to allow taking into consideration foreign tax credit while deducting tax from salaries of expatriate employees working in India. This will give relief from the cascading cash outflow for such employees. Currently, an expat employee who work 180 days in India is likely to be subjected to TDS while also paying taxes in the home country. DTAA and provisions of the Act deliver taxability of income for an expat rendering service in India. The withholding tax provisions under section 192 of the Act do not permit the employer to take into account the foreign tax credit available to an expatriate. In such cases the expat is highly inconvenienced, as there is double deduction in India as well as outside India in the home country. The expat employee can only reduce its financial hardship by claiming a refund on tax return in India. If the provisions of section 192 were duly amended, this hardship of tax deduction and subsequent claim of refund would be avoided.

(i) Deduction/Carry Forward of Excess FTC

It is provided under sub-rule (5) that the credit shall be restricted to the amount of tax payable under the provisions of the Act and the excess credit is not allowed as a credit in the year in which income is offered to tax. It is recommended that the excess amount of foreign tax paid or deducted in foreign jurisdiction be allowed as a deduction from the income computation of assessee or allowed to be carried forward to future years.

(j) Branch Profit Tax

Many countries like USA, Canada, France, Philippines, Indonesia etc. levy an additional branch profit tax wherein the branches of foreign countries are taxed on profit after tax on repatriation of earning from the branch at the time of closure or termination of such branch. In some countries the branch profit tax is as high as 30%. In this regard, clarity is required under FTC rules on claiming of credit of branch profit tax or branch remittance tax against tax payable in India. If no credit is available deduction should be allowed as business expense while computing taxable income of assessee.

4.29. Personal Tax

4.29.1. Taxation of Employee Stock Option Plans for Migratory Employees - Section 17

Issue

- Section 17(2)(vi) of the Act, read with Rule 3 of the Rules deal with taxation of Employee Stock Option Plans (ESOPs). It is provided that the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate shall be taxable as perquisite in the hands of the employee. For this purpose, the value of any specified security or sweat equity shares shall be the fair market value of the specified security or sweat equity shares, as the case may be, on the date on which the option is exercised by the taxpayer, as reduced by the amount actually paid by, or recovered from, the taxpayer in respect of such security or shares.
- In this connection, what has not been appreciated is that ESOP shares stand on a different footing because on the date of exercise, the shares are subject to lock-in condition and cannot be considered to be a benefit and therefore, ought not to be fictionally treated as benefit and brought under the ambit of perquisites for taxation purposes. The Supreme Court, in CIT v. Infosys Technologies Ltd., [2008] 2 SCC 272, at page 277, had aptly held:

  "During the said period, the said shares had no realisable value, hence, there was no cash inflow to the employees on account of mere exercise of options. On the date when the options were exercised, it was not possible for the employees to foresee the future market value of the shares. Therefore, in our view, the benefit, if any, which arose on the date when the option stood exercised was only a notional benefit whose value was unascertainable. Therefore, in our view, the Department had erred in treating Rs. 165 crores as perquisite value being the difference in the market value of shares on the date of exercise of option and the total amount paid by the employees consequent upon exercise of the said options."
- It may be mentioned that only when Fringe Benefit Tax (FBT) was introduced by the Finance Act 2005, these provisions were changed for the purposes of taxation of ESOPs under FBT regime. Unfortunately, those very provisions have now been brought back by way of insertion in sub-clause (vi) of sub-Section (2) of Section 17 of the Act, after the abolition of FBT, which has caused a lot of anxiety. It is imperative that the earlier tax treatment be restored to facilitate the employers in retaining talented persons in the organization.

Recommendation

- It is suggested that ESOPs should not be subject to tax on notional perquisite value and taxed only on capital gains arising from the sale of shares, as was the position till 31st March 2006.

Issues

- Notwithstanding the above recommendation, taxation of ESOPs creates an issue in the case of migrating employees, who move from one country to another, while performing services for the company during the period between the grant date and the allotment date of the ESOP. The domestic tax law is unsettled on the taxation of such migrating employees and does not clearly provide for such cases.
- There was a specific clarification on proportionate taxability of benefits under the erstwhile FBT regime, where the employee was based in India only for a part of the period between grant and vesting. However, there is no specific provision in this regard under the amended taxation regime from 1st April 2009.
- Considering the various judicial precedents on the issue only the proportionate benefit of ESOP pertaining to the services rendered by taxpayer in India should be taxable in India and not the entire benefit.

Recommendation

- A specific clarification should be inserted with respect to taxability of only proportionate ESOP benefit based on residential status of the individual, where an employee was based in India for only a part of the period between grant and vesting.

4.29.2. Taxation of National Pension Scheme

Currently, the National Pension Scheme (NPS) works on Exempt, Exempt, Tax (EET) regime whereby the monthly/ periodic contributions during the pension accumulation phase are allowed as deduction and the returns generated on these contributions during the accumulation phase are also exempt from tax, however, the terminal benefits on exit or superannuation, in the form of lump sum withdrawals, are partially taxable in the hands of the taxpayer in the year of receipt of such amount. An amendment was introduced by Finance Act, 2016, wherein forty percent of the accumulated corpus upon withdrawal/ superannuation was made tax-free whilst balance corpus of sixty percent continues to be taxable.

Issue

- In order to encourage taxpayers to make voluntary higher contributions towards NPS, it should be made more tax-friendly as the objective of this scheme is to create a pensionable society. Accordingly, the tax regime of NPS should be made Exempt, Exempt, Exempt (EEE) from the current EET regime on the lines of other retirement schemes like Employee Provident Fund and Public Provident Fund.
- Without prejudice to above, the benefit of 40% exemption for withdrawal from National Pension Scheme (NPS) by any employee be extended to withdrawals by any person and not just employees. It is suggested the sub-section (12A) of section 10 of the Act providing for exemption of 40% of payment from NPS Trust to “an employee” on closure of account or opting out of pension scheme, may be modified to allow such exemption to payment from the NPS Trust to “an individual”, since exemption under the said clause is available in respect of withdrawals from NPS by self-employed individuals also.

4.29.3. Taxation of contribution to Superannuation Fund in excess of Rs. 1.5 lakh - Section 17

Issues

- Section 17(2)(vii) amended by the Finance Act, 2016 provides that the amount of any contribution to any approved superannuation fund by the employer in excess of Rs. 1.5 lakh will be taxable as perquisite in the hands of the employee.
- It has to be appreciated that contributions to superannuation fund may or may not result in superannuation benefits to the employees, since there are various conditions to be fulfilled by the employees like serving a stipulated number of years, reaching a certain age etc. Further, the pension payments are subject to tax at the time of actual receipt by the employee after his retirement. This may lead to partial double taxation for the employee where the contributions had been taxed earlier also (when the contributions exceeded Rs. 1.5 lakhs).

Recommendation

- It is recommended that employer contribution to approved superannuation fund be made fully exempt from tax.

4.29.4. Taxation of Rent Free Accommodation (RFA)/Concessional RFA

Issues

- Section 17(2) of the Act provides for valuation of perquisite in case of provision of rent free accommodation by the employer to the employee or by way of concession in rent in respect of such accommodation provided. In case of accommodation provided by the employer other than Central Government or any State Government, Rule 3 of the Rules provides for valuation of perquisite at specified rate of 15% or 10% or 7.5% of salary based on the size of population as per 2001 census. However, the above method of determination of the perquisite suffers from various inequities:-
  - An employee staying in the same company owned accommodation will have a different perquisite value with increase in salary and further, employees with difference in salaries will have a different perquisite value in respect of the same accommodation.
  - The determination of the perquisite value of the accommodation based on the salary of the employee irrespective of the size/fair rental value of the accommodation is completely illogical and unfair.
  - The perquisite value in respect of accommodation provided to employees of Central/State Government is based on license fee charged for such accommodation as reduced by rent actually paid by the employee. The valuation rules cast discrimination between employee of Central/State Government and any other employee.

Recommendation

- FICCI recommends that the rule for computing perquisite value of rent free accommodation should be suitably amended. For computing the perquisite value, the value of the accommodation should be Fair Rental Value based on the valuation report obtained from the municipal authorities (without making any discrimination between employee of Central/State Government and any other employee).

4.29.5. Deduction for Investment in Infrastructure bonds

Issue

- Finance Act, 2010 had introduced section 80CCF w.e.f. April 1, 2011, which stipulated that deduction would be available to the individuals in respect of subscription in notified long term infrastructure bonds. This deduction

under section 80CCF of the Act was over and above the existing aggregate limit of deduction allowable under section 80C, 80CC and 80CCD of the Act. However, the said deduction was discontinued w.e.f. Assessment Year 2013-14.

Recommendation

- It is desirable that the benefit under this section is not limited for two years as the intent behind this introduction of this section is to promote raising of funds for infrastructural development.
- Accordingly, it is suggested that suitable changes be made in this section so that this deduction is available in future years.

4.29.6. Revival of Standard Deduction

Issues

- A standard deduction was earlier available to the salaried individuals from their taxable salary income. However, the same was abolished with effect from AY 2006-07.
- On the other hand, business expenses continued to remain as permissible deductions from taxable business income.
- It has to be appreciated that standard deduction is not a personal allowance and used to be given as a lump sum for meeting employment related expenses. In many countries like Malaysia, Indonesia, Germany, France, Japan, Thailand etc., allowance in the form of standard deduction is available for salaried employees for expenses connected with salary income.

Recommendations

- The standard deduction for salaried employees should be reinstated to at least Rs. 100,000 to ease the tax burden of the employees and keeping in mind the rate of inflation and purchasing power of the salaried individual, which is dependent on salary available for disbursement.
- This should also reduce the disparity between salaried and business class with only the latter being eligible for deduction for expenses incurred by them for earning their income.

4.29.7. Transportation Allowance - Section 10

Issues

- The transport allowance granted by the employer to the employee to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty is currently tax exempt up to Rs. 1600 per month in terms of Section 10(14) of the Act read with Rule 2BB of the Rules. The limit was marginally increased from Rs. 800 per month to Rs. 1600 per month in the last budget.
- The exemption limit of Rs. 1600 per month seems quite nominal considering the ever rising fuel costs and resultant conveyance costs.

Recommendation

- The exemption limit of Rs. 1600 per month needs to be considerably raised upwards, say to minimum of Rs. 3,000 per month to bring it in line with the rising conveyance costs.

4.29.8. Education Allowance

Issues

- The education allowance granted by the employer to the employee to meet the cost of education expenditure up to two children is currently tax exempt up to Rs. 100 per month per child in terms of Section 10(14) of the Act read with Rule 2BB of the Rules.
- This exemption limit was fixed in the year 2000 with retrospective effect from 1 August 1997 and seems extremely minimal considering the burgeoning cost of education.

Recommendation

- The exemption limit of Rs. 100 per month needs to be considerably raised upwards, at the very least to Rs. 2,500 per month to bring it in line with the rising inflation and cost of education.

4.29.9. Reimbursement of Medical Expenditure

Issues

- Any sum paid by the employer in respect of any expenditure incurred by the employee on the medical treatment of self/ family is currently exempt from tax, to the extent of Rs. 15,000 per annum.
- This limit was last revised long back and needs to be revisited in light of the rising medical and hospitalization costs especially for private hospitals.
- The expenditure incurred by/ for retired employees in respect of medical treatment on self/ family is currently not exempt from tax.

Recommendations

- The current tax exemption limit of Rs. 15,000 per annum needs to be increased to at least Rs. 50,000 per annum.
- Further, the exemption in respect of expenditure on medical reimbursements/ hospitalization expenditure in approved hospitals should also be extended to retired employees.

4.29.10. Tax Exemption in respect of Leave Travel Concession (LTC) - Section 10

Issues

- Presently, the economy class air fare for going to anywhere in India is tax exempt (twice in block of four years). However, this exemption is being allowed only for travel within India.
- Lately, owing to low airfares and package tours, a number of Indians prefer going abroad, instead of availing LTC, particularly to neighbouring countries like Thailand, Malaysia, Sri Lanka, Mauritius, etc., as the fares thereto are at times less than for travelling to some far away destination within India.

Recommendations

- It is therefore recommended to grant tax exemption for economy class airfare for travel abroad also, so long these are within the overall airfare tax exemption conditions for travelling in India. Further, considering the current prevailing trend in respect of foreign travel, there is a need to include overseas travel as well for the purpose of exemption or at least to exempt proportionate expenses pertaining to travel within India in case of joint travel (within India and overseas destination).
- Further, under Rule 2B of the Rules, the amount exempt in respect of LTC by air is to the extent of the economy fare of National Carrier i.e. Indian Airlines. It is suggested that word “National Carrier” should be deleted from Rule 2B.

- Moreover, as per the current provisions, Leave Travel Concession/ Assistance is eligible for tax relief for 2 calendar years in a block of 4 calendar years. It is suggested that the concept of calendar year should be replaced with FY (April – March) in line with the other provisions of the Income Tax Law and further exemption should be made available in respect of at least one journey in each FY.

4.29.11. Taxation of Social Security Contributions in the hands of Expatriates - Section 17

Issues

- In respect of an expatriate employee deputed to India, the home employer and employee may be required to contribute to social security schemes under the local law of country. In most cases, the contributions made to these schemes may not vest on the employee at the time of making the contributions and thereby do not provide any immediate benefit to the employee. Further, the employee contributions may also be mandatory under the law of the home country. Both the employer and employee contributions may be available as a deduction from taxable income in the home country of the expatriates.
- However, currently there is no provision under the Act, which provides for the taxability or otherwise in respect of such contributions from taxable income, though there have been several favourable judicial precedents to this effect such as CIT v. L.W. Russel [1964] 53 ITR 91 (SC), Gallotti Raoul v. ACIT [1997] 61 ITD 453 (Mum), ITO v. Lukas Fole (Pune) (2009-TIOL-556), CIT v. NHK Japan Broadcasting Corporation [Civil Appeal No. 1712 of 2009 – SC].
- Recently, even the Delhi HC pronounced the decision in case of Yoshio Kubo, wherein it was held that employer's contribution to overseas social security, pension and medical/ health insurance do not qualify as perquisite under Section 17(1)(v) of the Act and are not taxable in the hands of the employees.

Recommendation

- It needs to be clarified under the Act, that employer contributions to such social security schemes should be exempt in the hands of the individual employee based on the principle of vesting. Further, the employee contributions should be available as a deduction where the same are mandatory and constitute diversion of income by overriding title.

4.29.12. Provision of Treaty benefits while calculating TDS under Section 192

Issues

- Currently, there is no provision in the Act, enabling the employer to consider admissible treaty benefits (e.g. credits for taxes paid in another country/ treaty exclusions of income), while TDS under Section 192 of the Act from salary income.
- This creates cash flow issues for the expatriates who are initially subject to deduction of tax by their employers and then are required to claim large refunds on account of treaty benefits at the time of filing their return of income. Many of these expatriates may complete their assignments and leave India prior to obtaining their tax refunds which also creates issues with respect to credit of their refund amounts.

Recommendation

- Since the credit is otherwise admissible in terms of Section 90/ 91 of the Act, a suitable amendment may be incorporated in Section 192 of the Act providing for the employer to consider such credits/ exclusions at the time of deducting taxes.

4.29.13. Threshold Limit under Section 80C of the Act

Issues

- Over the years, investments made in various avenues available under Section 80C of the Act have helped the Government to raise funds as well as the individuals to save tax.
- However, with too many investment/ expenditures clubbed into the existing overall limit of Rs. 150,000 (including contribution to pension funds under Section 80CCC, pension scheme under Section 80CCD of the Act), individuals sometimes are discouraged from making further investments.

Recommendations

- There must be a clear distinction between long-term and short-term savings. So far there has not been any significant support in tax policy to actively encourage “long-term savings” which is very much needed. Life insurance and pensions are the main segments of the financial services that address the needs of individuals in the long-term. It would be equally desirable to have many more such tax-exempt investment avenues to mobilize funds for infrastructural and overall economic development. Therefore, the Government may consider separate exemption limits for such important avenues.
- Further, the Government may look at increasing the overall deduction limit to at least Rs. 300,000 to boost further investment and increase tax savings for the individual.
- Term deposits for a period of 5 years or more with a scheduled bank, in accordance with a scheme framed and notified by the Central Government, by an individual/ HUF is eligible for inclusion in gross qualifying amount for the purpose of deduction under Section 80C of the Act. For other eligible investments such as bonds and mutual funds, the lock in period is 3 years and to ensure parity, the period of term deposits for claiming deduction under Section 80C of the Act should also be reduced to 3 years from existing 5 years.

4.29.14. Overall deduction in respect of amount paid under Pension/Annuity Plans

Issue

- As per Section 80CCE of the Act, the overall ceiling for deduction is Rs.1.5 Lakhs for the payments covered by Section 80C, payment towards annuity plans covered by Section 80CCC and payment towards NPS covered by Section 80CCD.

Recommendation

- The overall ceiling limit of Section 80CCE should be enhanced to augment savings in the economy to promote economic growth.

4.29.15. Deduction for Educational Expenses

Issue

- Education of children these days imposes a heavy burden on the middle class. A good beginning was made in 2003 by providing deduction for tuition fees under Section 80C of the Act. But Section 80C of the Act is particularly a provision granting incentive for savings and also considering the long list of eligible investments in this Section, there is very little relief to the individual on account of the education fees incurred by him.

Recommendation

- It is therefore recommended to de-link deduction for educational expenses for children from Section 80C and provide under a separate provision like Section 80D of the Act for medical insurance. A reference to the Ministry

of Education to find out the tuition fee for an average middle class household will give an indication about the limit of the deduction.

4.29.16. Deduction in respect of Rent paid by Taxpayers not receiving a HRA

Issue

- Under Section 80GG of the Act, the maximum deduction available to individuals who do not receive a House Rent Allowance (HRA), in respect of rent paid has been enhanced to Rs. 5,000 per month by the Finance Act, 2016 from the earlier limit of Rs. 2000 per month. However, the exemption limit to the extent of Rs. 5000 per month is very less compared to the inflationary effect on rent over the years.

Recommendation

- The exemption needs to be increased to at least Rs. 15,000 per month in view of the huge rental escalation. As in the case of HRA exemption, the Government may also consider introducing separate limits for metro and non-metro cities.

4.29.17. Deduction in respect of Interest on Deposits in Savings Account - Section 80TTA

Issue

- Section 80TTA was inserted by the Finance Act, 2012 to provide deduction of up to Rs.10,000/- in the hands of individuals and HUFs in respect of interest on savings account with banks, post offices and co-operative societies carrying on business of banking. However, it is unlikely that salaried individuals would keep their entire savings in a savings bank account, which earns a much lower rate of interest as compared to term deposits. They are likely to transfer some portion of their savings to several deposits to earn comparatively better returns.

Recommendation

- It is suggested that the scope of Section 80TTA of the Act should be widened to incorporate all types of deposits (such as term deposits, recurring deposits etc.) made within the banking channels, thereby inducing savings for the growth of the economy. Further, the limit of deduction under this section may be increased from Rs. 10,000 to Rs. 15,000.

4.29.18. Electronic Meal Card

Issues and Recommendations

- The perquisite rules reinstated in December 2009, if food and non-alcoholic beverages are provided during working hours at office or business premises or through non-transferable paid vouchers usable only at eating joints, the value of facility to the extent of Rs. 50 per meal is exempt from the tax. This limit of Rs. 50 per meal was introduced way back in 2001-02 and has not been adjusted for inflation thereafter. The limit of Rs. 50 is practically redundant, obsolete and does not confer the desired benefit to employees.
- Many employers these days provide this facility through electronic meal swipe cards. However, the current rules expressly provide exemption to paid vouchers and not electronic cards though such cards were expressly exempted under the erstwhile FBT regime subject to conditions. Accordingly, their treatment is not free from doubt.
- It is recommended that tax-exemption limit of Rs. 50 per meal should be revised to at least Rs. 200 per meal, considering the inflation over the 15 years on food items. It is also recommended that the said exemption along with increased limit should be extended to electronic meal vouchers.

4.29.19. Exemption for payment of Leave Encashment - Section 10

Issue

- The exemption limit for leave encashment paid at the time of retirement or otherwise is notified by the CBDT in accordance with the powers given under Section 10(10AA) of the Act. The current limit of Rs. 3 lakhs was notified in 1998 and needs to be raised substantially with immediate effect.

Recommendation

- It is, therefore, suggested that the limit should be raised to Rs.10 lakhs in line with the increase in the limit of gratuity.

4.29.20. Relaxation in Proof of Address for Foreign Nationals for obtaining PAN

Issue

Currently, a foreign national is required to submit a national ID duly attested/apostilled from the Indian Embassy in his home country as an address proof while filing application in Form 49AA for obtaining PAN.

Recommendation

In order to avoid such hardships, a certificate from the Indian company for whom such individual is coming to work in India, certifying the identity of the individual and his foreign address may be accepted as an address proof.

4.29.21. Income of Minors - to increase Exemption Limits under Section 10(32) of the Act

Issue

- As per Section 10(32) of the Act, in case the income of an individual includes the income of his minor child in terms of Section 64(1A), such individual shall be entitled to exemption of Rs.1,500 in respect of each minor child if the income of such minor as includible under Section 64(1A) exceeds that amount.
- The current limit of Rs. 1,500 was fixed by the Finance Act, 1992 and needs to be raised substantially with immediate effect.

Recommendation

- It is suggested that the limit of exemption under Section 10(32) of the Act should be raised to at least Rs. 10,000 for each minor child.

4.30. Other Direct Tax provisions

4.30.1. Calculation of Interest for delay in Deposit of Taxes deducted - meaning of 'Month'

Issue

- As per Section 201 (1A) of the Act, interest on late deduction of TDS is calculated @1% for every month or part of month from the date on which tax was actually deductible to the date on which tax was deducted and interest on late deposit of TDS is calculated at 1.5% for every month or part of month from the date on which tax was deducted to the date on which tax is actually paid. However, for the purpose of calculating period of delay, the Revenue Authorities calculate interest on a calendar month basis. For instance, where tax was deductible on 30 June and the tax so deducted was remitted on 8 July, interest has to be paid for June and July (i.e. 2 months) for a one day delay.

Recommendation

- In order to mitigate this hardship caused to the taxpayer, it is suggested that 'month' be defined as a period of 30 days to avoid litigation on this issue. This would make the reckoning of period while interpreting the tax law more meaningful and clear.

4.30.2. Set Off of Refunds against Tax remaining Payable

Issue

Adjustment of refunds due to assessees against erroneous demands shown outstanding in their cases causes great heartburn. Even where the assessee lodges his objection on the CPC portal pointing out that the demand sought to be adjusted against the refund was not outstanding and therefore is being erroneously adjusted, there is no remedy by which the CPC can take note of the same.

It is settled by several judicial pronouncements that where any demand outstanding against the assessee relates to a point which stands squarely covered by a decision in the assessee's favour, such demand cannot be adjusted against any refund due to the assessee. Courts have logically explained in this regard that the assessee in such a case would have been undisputedly entitled to stay on recovery of such demand, and merely because the Department is in possession of the assessee's funds due to him as legitimate refund, it cannot be adjusted against such a demand.

Recommendation

It is suggested to amend the section so as to provide that no set-off of refund under this section shall be made by any income-tax authority without giving intimation in writing to such person of the action proposed to be taken under this section, and without dealing with the objections, if any, filed by such person in response to such intimation served on him. Systems should be amended/ put in place to stop assessees' funds being adjusted without authority of law.

4.30.3. Interest Payable in case of Default in furnishing Return - Section 234A

Issue

- Where return of income is filed after the due date, interest under Section 234A of the Act is levied from the due date of filing return till the date of actual filing. Currently, while computing the amount on which interest is payable, self-assessment tax paid by the taxpayer is not considered. Consequently, the taxpayer has to pay a higher amount of interest.

Recommendation

- Since interest is not a penalty and the reason for levy of interest is only to compensate the revenue, in order to avoid it from being deprived of the payment of tax on the due date, it is suggested that in cases where the tax on self-assessment is paid under Section 140A of the Act before the due date for filing return on income but return has been filed after the due date, such tax on self-assessment should be considered as item of deduction for the levy of interest under Section 234A of the Act.

4.30.4. Modification of Income Tax Form to allow proper Disclosure

Issue

- Various positions are taken by the taxpayer at the time of filing the return of income. However, due to the limitation in the format of the income tax return/form, the taxpayer is not able to provide all disclosures in respect of the positions taken by him in the return which has impacted the computation of income/loss of the taxpayer.

Recommendation

- It is recommended that the income tax return form should be appropriately modified to provide adequate space for writing notes to the return of income.

4.30.5. Fresh Claim made during the Assessment Proceedings

Issue

- The tax officers reject the claims made by the taxpayers during the course of the assessment proceedings which are omitted to be claimed by the latter in their return of income.

Recommendation

- The Act should be suitably amended to specifically state that a taxpayer can make claim for any exemption, deduction, set-off or any other relief at the time of assessment proceedings as well and such claim should be regarded as having made in the return of income for the purposes of the Act.

4.30.6. Time Limit for completion of Appeals by Appellate Authorities

Issue

- The Act does not specify any time limit within which the appeals filed before the appellate authorities must be disposed of. This results in undue hardship and never ending litigation cost to the taxpayer.

Recommendation

- It is suggested that suitable provision may be incorporated in the Act to prescribe specified time limits for disposal of appeals in a timely manner at all appellate levels.

4.30.7. Inclusive Method of Accounting - Section 145A

Issue

- The conflict in the provisions of Section 145A of the Act and the Accounting Standards notwithstanding its nil impact on the Profit and Loss or taxable income has transformed itself into long drawn unwarranted litigation.

Recommendation

- It is recommended that provision of Section 145A of the Act be amended to fall in line with the Accounting Standards.
- Alternatively, it is recommended that the said provision be deleted, since in ultimate analysis, there is no revenue implication.

4.30.8. Allow Prior period Expenditure in the year of claim

Issue

In the large organizations, prior period expenditure is bound to arise. Currently, such expenditure is not allowed in the financial year in which it is actually debited to the profit and loss account. The only option available with the taxpayer is to make a claim for the prior period expenditure by filing a revised return (if time for filing revised return has not lapsed) or litigate the matter with the appropriate appellate authority to allow such expenditure in the year to which it relates. The allowability of the prior period expenditure has caused undue hardship on the taxpayer.

Recommendation

It is recommended that the prior period expenditure may be allowed to the taxpayer in the year in which it is debited to the books of account of the taxpayer.

4.30.9. Rate of Interest on Tax Refunds – Sec 244A

Issue

Under section 244A of the Act interest is computed @ 6% per annum on tax refunds payable by the Government however in cases of interest payable by the assessee to the Government, such as in section 234B, rate is 12% p.a.

Recommendation

A uniform rate of interest of either 6% or 12% p.a. both for refunds and tax dues payable by the Government and assesses respectively may be prescribed.

4.30.10. Penalty for under Reporting and Misreporting of Income – Section 270A

The Finance Act, 2016 has amended the provisions for levy of penalty on account of concealment of particulars of income or furnishing inaccurate particulars of income by inserting section 270A in the Act to reduce the discretionary power given to the tax officer and to bring objectivity, certainty and clarity in levy of penalty. It is provided in section 270A of the Act that the penalty at the rate of 50% of tax be leviable in case of underreporting of income and 200% in tax in case of misreporting.

Issues

- The way the provisions for levy of penalty under section 270A of the Act are worded, it is comprehended that any claim made by the assesse not accepted by the assessing officer for example disallowance of expenditure on account of difference in interpretation on a matter of a question of law would attract automatic penalty @50% of tax on under-reported income. This would entail unwarranted litigation.
- There is no mechanism provided in the Act to make an appeal to the Commissioner of Income-Tax (Appeals) against the penalty order passed by the assessing officer under section 270A of the Act. This is against the principles of natural justice.

Recommendations

- It is recommended that further necessary changes be made/guidelines released to ensure that the new penalty provisions are not arbitrarily applied by the tax authorities. Certain controls may be required in the effective implementation of the section. In order to reduce the practice of Assessing Officers treating every concealed income as misreported as well as the fact that the new section does not require recording of satisfaction before imposition of penalty proceedings (as was required under the erstwhile section 271), it is desirable that a suitable control mechanism may be put in place. It is further suggested that suitable amendments be introduced or alternatively administrative instructions may be issued so that each order contains the specific fact of either misreported income or under-reported income or both along with the mention of specific clause of section 270A(2)/(9) of the Act against each disallowance/addition.
- An amendment should be provided in section 246A of the Act to allow filing of appeal against the penalty order passed by the assessing officer under section 270A of the Act.

4.30.11. Time Limit for Waiver of Penalty – Section 273A, Section 273AA and Section 220(2A)

Issue

A time limit of one year for disposal of an assessee's revision petition under section 264 has been prescribed, there is no such time limit for disposal of petition for waiver of penalty under section 273A and 273AA and waiver of interest under section 220, 234A/B/C of the Act. As a result, petitions of assessees on these points remain unattended to for long. Sections 273A, 273AA and 220(2A) may be suitably amended, and CBDT may issue suitable directions under section 119(2)(a) providing for such time limit for disposal of petitions for waiver of interest thereunder, providing for time limit for disposal of petitions for waiver of interest under sections 234A, 234B and 234C of the Act.

Recommendation

It is highly desirable that a limit of one year from the end of the financial year in which the petition is filed should be prescribed in all these cases.

4.30.12. Fee for Default in Furnishing Statements – Section 234E

Issue

The levy of mandatory fee under section 234E at Rs.200/- per day for default in furnishing of statements of TDS under section 200(3) and TCS under section 206C(3) has been a matter of debate ever since it came to be introduced with effect from 1 July 2012. While in principle, courts and tribunals have justified the levy as being constitutional, it is widely believed that this levy is harsh, keeping in view the fact that a person committing defaults of delayed deduction or payment of tax is already inflicted with non-deductible penal interest of 12% or 18% per annum. Moreover, in cases of grave default of non-furnishing of such Statements beyond one year, there is also a provision for levy of penalty of Rs.10,000 to Rs. 1,00,000.

Recommendation

Prior to introduction of the mandatory levy, the penalty for similar defaults as provided under section 272A(2)(k) was imposable at Rs.100/- per day. In cases of any default by a Government Office, while there is no provision for levy of fee under section 234E, the penalty for similar defaults under section 272A(2)(m) is prescribed at Rs.100/- per day. It is recommended that the fee under section 234E should be reduced from Rs.200/- per day to no more than Rs.100/- per day.

4.30.13. Direction for Special Audit under sub-section (2A) of Section 142 of the Act

The Finance Act, 2013 has made an amendment to Section 142(2A) of the Act which widens the power of the Assessing Officer to direct the taxpayer to get accounts audited and furnish the report in certain circumstances. The expression "nature and complexity of the accounts" has been replaced with the "nature and complexity of the accounts, volume of the accounts, doubts about the correctness of the accounts, multiplicity of transactions in the accounts or specialized nature of business activity of the assesse".

Issues

- The amendment seeks to enlarge the scope of Section 142(2A) of the Act and gives sweeping powers to the assessing officer to direct special audit in most of the cases.
- The conditions prescribed for referring the case for special audit are not interdependent i.e. even one of the conditions could trigger recommendation for special audit. The applicability of this provision merely on the basis of volume of the accounts or multiplicity of transactions in the account is unreasonable since in such a case, all big companies with voluminous transaction could be referred for special audit. The amendment will result in unwarranted litigation.

- Reasons such as volume of accounts, multiplicity of transactions in the accounts, specialized nature of business activity of taxpayer etc. are not defined categorically to state the quantum/ threshold etc. for initiating a special audit.

Recommendations

- Applicability of this provision should not be invoked merely on the basis of volume of the accounts or multiplicity of transactions in the account. The provision should be amended to require satisfaction of all the conditions cumulatively for directing for special audit under Section 142(2A) of the Act.
- The terms such as “volume of accounts”, “multiplicity of transactions in the accounts” and “specialized nature of business activity of assessee” would need to be defined very clearly in the Section in order to avoid litigation/ ambiguity in the interpretation of the Section.

4.30.14. Scope and Powers of Dispute Resolution Panel (‘DRP’) – Section 144C

Recommendations

In line with the objective for which DRP was set up, the following suggestions are made:

- It is suggested that the constitution of DRP should act like an independent judicial body rather than just a departmental body lending support to tax officers. The members of the DRP should have statutory powers and authority like members of the ITAT or AAR.
- Settlement powers should be bestowed upon the DRP Panel so as to enable them to expedite the long litigated matters and close them in a timely manner.
- Tax officers should also be made accountable for their orders.

4.30.15. Monetary Limit for Audit of Accounts

Issue

Currently the limits for audit of accounts of taxpayers are as follows:-

Particulars	Existing Limit (Rs. Lakhs)
Sales turnover/ Gross receipts of business	100

Recommendation

Given the growth in volume of economic activity, the limits need to be revised as under:-

Particulars	Proposed (Rs. Lakhs)
Sales turnover/Gross receipts of business	500

INDIRECT TAXES

Measures to Rationalize the Indirect Tax System

5.1.1. Processing of Refunds

The disbursal of refunds of Customs and Central Excise duties and Service tax goes on for prolonged periods thereby distressing the assessee and causing financial crunch to them. Generally there is a tendency to deny the refunds for some reason or the other. The refund is rejected on irrational grounds due to which the assessee is left with no other option but to litigate the matter further. There is an urgent need to review the Standard Operating Procedure for processing refunds. Following suggestions may be considered in this behalf:-

- Automate the process of sanctioning refunds enabling tracking of each stage of processing
- Uniformity – Specify requirement of documents to be filed for refunds in various situations across jurisdiction/ assessing authorities
- Prescribe time limits for –
    1. issue of automated receipt (with reference number and date), and
    2. processing and sanction of refund claim;

  and each stage of processing should be displayed on the website
- Send timely communication to assessee on completeness of documentation upon submission of refund claim and process claim within the prescribed time limit
- Refund claims to be processed in the sequence of their date of filing to achieve transparency – Status of processing of all refund claims should be displayed
- Interest should be paid automatically for delayed sanction of refund beyond the prescribed time limit. Rate of interest for delayed payment should be the same as the rate for recovery of duties / taxes not paid or short paid
- Consequential refund arising out of favourable appellate orders should be suo-moto processed
- Authorities resorting to unwarranted delay in processing of refund claims should be held accountable
- Introduce a system for monitoring of refund cases remanded back to adjudication authority for early disposal

5.1.2. Systemic Measures to address Inverted Duty Structure

An inverted duty structure refers to a situation where manufacturers have to pay a higher duty on raw material while the resultant finished product attracts lower duty. In the absence of a duty refund mechanism, this coupled with service tax credit, which a manufacturer is entitled to as a service receiver, results in accumulation of credits over a sustained period of time. This is more acute where the manufacturer sources most of his raw materials from abroad and value addition on finished product is not very high.

As an example, on import of intermediate raw materials, a Company claims 17.74% credit on Customs Duty while the corresponding finished product is charged to 12.36% duty. This means that to fully utilize the credit, Company has to have a value addition of at least 45%. After taking into account the service tax credit, the accumulation gets even higher with no corresponding liability to set-off. Similarly in pharmaceutical industry, the input/input service and capital goods credit comes at higher rate of 12.5% in case of Central Excise and 14% in case of Service Tax; whereas the final product that is medicaments attract duty of 6%.This results in significant blockage of working capital funds and therefore entails higher interest cost to carry on business in India.

A legal provision to refund such unutilized credit at the end of every financial year will bring relief to all such manufacturers and will act as a catalyst for encouraging Investments in setting up manufacturing facilities in India.

5.1.3. Safeguards against threats of Arrest

There have been several instances of officials (especially in the course of field audits) threatening taxpayers with arrest / prosecution unless disputed amounts of tax discovered during investigations / audit (including those that arise due to genuine interpretational differences) are immediately paid. Such amounts are required to be deposited even before an opportunity is provided to the assessee by issuing him a show cause notice to explain the "short payment / non-payment" etc. This leads to significant hardship to taxpayers, and goes against the principle of natural justice.

Even in the most recent circular issued by the CBEC on 30 September 2016, it is provided that there may not be a need for arrest if the alleged offender has deposited at least half of the evaded tax. This exacerbates this problem, and further incentivizes officials to insist on payment under threat of arrest.

It is requested that adequate safeguards be provided in law in order to ensure that coercive measures are not used to demand excise, service tax, and customs duties in case of disputes involving duty payments/credits. Suitable administrative measures need to be put in place to deter the officers from routinely summoning senior executives and issuing threats of arrest and prosecution while seeking to demand payment of disputed tax amounts. Guidelines be prescribed listing out the specific Dos and Don'ts for the officers to observe in situations where the officers feel that there has been a short payment or a non-payment and they seek to recover the amounts even before a show cause notice is issued. Correspondingly there should be a charter of rights for the taxpayers to ensure that the officers do not misbehave with the taxpayers. No coercive measures be initiated till at least the adjudication is over

5.1.4. Safeguards against Invoking the Extended Time-limit for demanding Disputed Duties

The Customs, Central Excise and Service Tax laws permit the tax officers to raise a demand for a period of past 5 years in case any short levy is noticed because of a willful mis-declaration, collusion or fraud on the part of the assessee. In normal cases of disputes, the demand can be raised for a period of past one year only. It is observed that the Revenue Officers invoke mis-declaration / fraud etc. as a matter of routine and issue show cause notices demanding duties and taxes for the past 5 years. Even though the law requires the extended period of 5 years to be invoked only with the approval of the Commissioner of Customs, Central Excise or Service Tax, it is observed that such concurrence is granted by the senior officers routinely without carefully examining the merits of the case. Relief in such cases is granted only when the matter reaches the Appellate Tribunal in appeal.

It is suggested that appropriate safeguards be provided to prevent invocation of the extended period of demand in a routine manner.

5.1.5. Time Limit for Adjudication of Show Cause Notices

At present, no time limit is prescribed under the law for adjudication of the show cause notices issued by the department. As a result, there are certain cases, where the show cause notices are not adjudicated by the authorities for a number of years. This practice is more common where the show cause notices are issued pursuant to audit objection raised by CERA. These show cause notices are transferred to call books and not adjudicated for a long period of time.

This creates an uncertainty for the assessee as a number of business decisions are kept on hold due to lack of clarity on the issues for which the dispute is raised by the department vide issuance of show cause notice.

We therefore request you to kindly prescribe some time limit for adjudication of the Show Cause Notices by the department so that the issues are not kept open indefinitely. It is requested that a suitable amendment should be made in law to provide that if the Show Cause Notices issued by the department are not disposed in a time bound manner, the issue shall be deemed to be settled in the favour of assessee.

5.1.6. Rate of Interest

There is a divergence in the interest rates charged and paid by the Government on tax dues. In Income-tax, interest is charged by the Government at 12%, while it pays only 6% on refunds (which is increased to 9% in certain cases of delayed refunds). In the context of indirect taxes, the Government charges 15% while paying only 6% on refunds.

There must be a uniform rate of interest for both interest charged and interest paid by the Government. In any event, this position must be consistent across all statutory levies and must not vary between direct and indirect taxes.

5.1.7. CESTAT - Enhancement of Financial Limit for Jurisdiction of Single Member, etc.

Presently the jurisdiction limit of Single Member of the Customs, Excise and Service Tax Appellate Tribunal (CESTAT) is Rs. 50 Lacs to dispose of main appeals except cases involving dispute of classification, valuation and rate of duty which are dealt by division bench.

It is requested that for expeditious disposal of cases pending before the various CESTAT benches, limit may be increased to Rs. 2 Crore for hearing the main appeal by Single Member benches. Further, the said limit be made applicable for all types of cases and should include issues of classification, valuation and rate of duty as at present.

It is further requested that separate benches of CESTAT be set up to fast track high value litigation so as to bring about finality to the liability, if any, of taxpayers. It will also enable the Revenue to quickly recover the taxes due to it.

SERVICE TAX

Levy and Exemptions

5.2.1. Extension to the Scope of Negative List of Services - Agriculture

A negative list of services has been provided by introduction of section 66D to the Finance Act, 1994 with effect from 1st July 2012 through which any services included in the list are outside the ambit of service tax.

Specified services relating to agriculture or agricultural produce have been included in the negative list of services e.g. agricultural operations, supply of farm labour, processing of agro produce, loading, unloading, storage, renting or leasing of vacant land or agro machinery etc. However, there are certain other input services received by such entities which are not included in the negative list of services such as transportation of packing material, works contracts, manpower supply, security, import of services for installation and erection of agro related plant and machinery etc. Non-inclusion of complete list of services availed by the service recipients/entities engaged in agricultural sector is leading to increase in cost base of these entities, as these entities do not have any output service tax liability

It is recommended that an amendment be made extending the scope of Section 66D to all services, whether direct or indirect to agriculture or agricultural produce instead of limiting the exemption to the specified services.

5.2.2. Applicability of Krishi Kalyan Cess to Agricultural Sector

Finance Act, 2016 has proposed to levy Krishi Kalyan Cess at the rate of 0.5% on all taxable services whereby the effective tax rate will increase to 15%.

The entities engaged in agricultural sector do not have any taxable goods or services as their output is exempt in most cases. Therefore, the tax paid if any on inputs and input services will be a cost to the respective entities. Further, the objective of Krishi Kalyan Cess is to provide support to the Agricultural sector in the country. The entities engaged in the agricultural sector contribute to the development of the agri sector by procurement of agri inputs. Therefore, it is important to incentivize the businesses in agri sector with various tax exemptions, more so not to impose additional taxes and increase the tax burden. Although, CENVAT credit can be availed of the above tax, the levy of tax shall be an additional cost as the output is exempt from tax

It is recommended that a suitable amendment be made whereby service tax paid on the inputs by the businesses engaged in agricultural sector be claimed as a refund.

5.2.3. Service Tax on Processing of Agricultural Commodities (Pulses)

Negative List of Services includes processes carried out at an agricultural farm including tending, pruning, cutting, harvesting, drying, cleaning, trimming, sun drying, fumigating, curing, sorting, grading, cooling or bulk packaging and such like operations which do not alter the essential characteristics of agricultural produce but makes it only marketable for the primary market. In case of processing of whole pulses to split pulses, such activity is carried out in factories. The price of the pulses is showing an upward trend in last few years owing to lower production, impact of weather, etc. Levy of service tax on such processing activities adds to the higher prices of pulses, which is a staple diet for the common man. On a similar corollary, Finance Ministry has exempted levy of service tax on processing of paddy into rice.

It is recommended that the processing of whole pulses into split pulses should be covered under negative list of service tax.

5.2.4. Services by a Job Worker to a Principal Manufacturer

The job workers are engaged by principal manufacturers to manufacture final or intermediate goods on their behalf. In order to manufacture the goods, there are various activities which the job worker may undertake for keeping the manufacturing facility in the state of readiness. Accordingly, the job worker either seeks financial assistance or commitment charges from the principal manufacturer.

Since payments made by the principal manufacturer to the job worker as assistance or commitment charge are in connection with the manufacture or production of final goods, service tax should not be levied on such payments. Also, in case the service tax is charged by the job worker, the same will not be available to credit by the principal manufacturer, thus leading to cascading of taxes

Further, carrying out production process by job worker in relation to any goods on which appropriate duty is payable by the principal manufacturer has been exempted from service tax. This leads to a situation wherein a job worker in relation to the said activity is regarded as a provider of an exempted service. The job worker, therefore, is not entitled to CENVAT credit on input or input services. Since a job worker under the Central Excise is regarded as a manufacturer, he cannot be said to be a service provider concurrently.

Definition of service under Section 65A (44) of the Finance Act, 1994 be amended so as to exclude any service provided by a job worker to the principal manufacturer directly or indirectly in or in relation to and in connection with the manufacture and production of goods or processing of any goods by the job worker for further use in the manufacture and production of final product by principal manufacturer.

5.2.5. Service Tax on Transactions between Head Office and Branch Office

Under the service tax regime, any transaction between an establishment outside India and an establishment in India of the same entity would be treated as a 'service'. A branch or any other establishment of a person located in a non-taxable territory would be deemed to be a distinct "person" for service tax purposes.

At present service transaction in India between same legal entities is non-taxable. It is suggested that no service tax be levied on outbound service transaction provided to same entity by an office located in taxable territory to another office of the same legal entity located in non-taxable territory.

5.2.6. Service Tax on Transportation of Goods through Vessels

Central Government has notified negative list of services (Section 66D of the Finance Act, 1994) in 2012. One of the services in the negative list included "*Services by way of transportation of goods by an aircraft or a vessel from a place outside India up to the customs station of clearance*"

Accordingly, ocean freight paid for import of goods from a place outside India to customs station in India was outside the ambit of service tax. Finance Act, 2016 has, however, removed such exemption for transportation of goods by vessel. Therefore, the service recipient who engages shipping liner shall pay tax under reverse charge mechanism. The amendment to the negative list to impose service tax on ocean freight has increased the cost of vessel transport by 15% to the final importer. Further, for import of goods, the assessable value for the purpose of calculation of basic customs duty is done on CIF basis. Effectively, the freight paid is suffering double taxation (Customs duty and Service tax).

It is recommended to keep ocean freight (import) outside the purview of service tax.

5.2.7. Service Tax on Funds received from Central Government as Aid

Service Tax Authorities have been issuing show-cause notices and also raising demands for Service Tax on the Government grants-in-aid. This is creating immense hindrance in carrying out mass socio-economic reform activities for persons below the poverty line in India.

Many a times private entrepreneurs partner with Government Authorities for developing infrastructure facilities across the country and especially in the rural areas for masses to achieve the overall socio-economic objectives of the Government of India by forming Public – Private Partnership (PPP Model). Service tax Exemption on Government aid/ grant received for Socio – economic development for rural masses should be allowed. Further, the receipt of Government Grant should specifically be covered by the Negative List of Services specified in the Act.

5.2.8. Service Tax on Regulatory/Statutory Fees paid to Foreign Governments/ Agencies

In the budget presented for the year 2015-16, the definition of the term “Government” has been defined to mean Central Government or State Government or Departments of such Government, Union territory and its departments.

Chemical/Pharma companies are required to pay statutory fees to the Foreign Governments/agencies for registration of their products etc. A change in the definition has resulted in such payments being taxable in the hands of the Indian companies on reverse charge basis. This will result in huge service tax outflow, blocking of working capital.

Exemption from service tax should be provided on such payments made to any Foreign Government and agencies as they are statutory in nature.

5.2.9. Revision of Threshold Limit for Exemption

Notification No.8/2008-ST dated 01.03.2008, provides an option to the service providers, to avail exemption of Rs.10 lakhs (the aggregate value of taxable services), from payment of service tax. Since this threshold limit has not been revised for quite some time now, it is suggested that the threshold limit for exemption from payment of service tax be revised upwards from Rs. 10 lakhs to Rs.20 lakhs. This is the limit apparently agreed upon by the GST Council for GST also.

5.2.10. Exemption of Service Tax on Transportation of LNG by vessel and LNG Regasification

Since the domestic production of Natural Gas is not enough to cater the increasing demand, import of LNG at large scale is required to augment the supply of Natural Gas for use in priority sectors such as Fertilizer, CNG, LPG, PNG etc. Presently service tax (@15%) is applicable on the transportation of LNG by vessel/Ship from a place outside India to the first customs station of landing in India. Further, the imported LNG has to be re-gasified and converted into Natural Gas (known as RLNG - Regasified Liquefied Natural Gas) for transportation and consumption in India. The activity of regasification of LNG attracts Service Tax.

The levy of Service Tax on sea transportation of LNG and on the activity of regasification of LNG increases the landed cost of imported LNG for domestic industrial consumers. In order to promote gas-based industry in India, it is suggested that transportation of LNG by a vessel/Ship from a place outside India to India under voyage charter basis as well as time

charter basis may be exempted from levy of Service Tax. Similarly, the activity of regasification of LNG also needs to be exempted from levy of Service Tax.

5.2.11. Service Tax on Transmission and Distribution of Electricity

Under the Negative list "transmission or distribution of electricity by an electricity transmission or distribution utility" is not taxable (sec. 66D). Further, the definition of "electricity transmission or distribution utility" under sec 65B(23) of the Finance Act inter alia covers distribution licensee and "any other entity entrusted with such function by the Central Government or, as the case may be, the State Government". Under the negative list, service provided by an entity approved by Central or State Government is not taxable. However, any franchisee appointed by a private party (Distribution Licensee) is not covered under the negative list. Earlier notification no 32/2010 dated 22.06.2010 specifically exempted the taxable service provided to any person, by a distribution licensee, a distribution franchisee or any other person.

The benefit of earlier notification should be extended to current exemption list. All the franchisee appointed by a private party (Distribution Licensee) should also be covered under the definition of "electricity transmission or distribution utility."

5.2.12. Lease Rental Transactions – Levy of Service Tax and VAT

There are instances of lease rental transactions where the service tax authorities are of the opinion that the said transaction would come under the ambit of supply of tangible assets and thereby leviable to Service Tax. On the other hand the State VAT Authorities have distinguished the above observation and have held that providing goods on rental basis is an activity of 'Transfer of Right to use' and hence would fall within the definition of sales and would be liable to sales tax/VAT.

The above situation has created an anomaly to the extent as to whether a lease rental transaction would be liable to Sales tax or Service tax or both. In most of the cases, the assessees in order to avoid long drawn process of litigation are forced to pay both the taxes thereby leading to cascading effect of tax.

The respective legislative authorities should endeavour to lay down conditions precedent involved in both the transactions i.e. that of deemed service and deemed sales more explicitly. This would avoid the incidence of double taxation on the same lease rental transaction and also reduce unnecessary litigation.

5.2.13. Service Tax exemption to Services used in E&P Sector

At present the services in relation to survey and exploration of mineral Oil & Gas are taxable under the service tax. As the operators and their associates in E&P sector do not provide any taxable output service or do not manufactures any excisable goods, they are not able to set off the service tax paid and have to absorb the cost. Further, the risks and uncertainty associated with capital intensive E&P sector underlines the need of providing supportive environment for sustaining the business. After the increase in rate of Service Tax, the burden of input stage tax has further increased on E&P sector. Services related to core infrastructure sector activities like highways, airports, sea ports, metro, railways etc. are already exempted from service tax on economic considerations.

It is therefore suggested that the services consumed by the E&P sector may be included in the negative list of services in line with existing consideration given to services required for infrastructure development like roads, airport, railways, ports etc. It will incentivize investment in E&P sector by way of reduction in capital cost.

5.2.14. Double Taxation of Licensed Intellectual Property Right (VAT and Service Tax)

Temporary transfer or permitting the use or enjoyment of any intellectual property right is liable to service tax.

In light of various settled judicial precedents, intellectual property right (IPR) has also been held to be 'goods' and accordingly, since software supplied electronically constitutes goods, it is subjected to VAT under the respective State

VAT legislations. Further the 'temporary transfer of right to use software' is construed as a service and subject to levy of Service Tax. However there is still confusion and litigation existing as many State Governments are still levying sales tax on supply of temporary IPR, given the fact that the definition of sale in few state VAT legislations includes 'right to use'. The objective should be to do away with double taxation and bring about clarity on the fact whether IPR is 'goods' or 'service'.

It is recommended that suitable explanations should be added in the Finance Act itself to ensure that sale of IPR is taxed only once – either under VAT as goods or under Service tax legislation as taxable service.

Consequent upon 2016 budgetary amendment, all services provided by Government or a local authority to a business entity have been made taxable with effect from 1.4.2016. Accordingly Clause (d) of Section 66D i.e. Negative list was amended and the words "support services" was substituted by the words "any services". However, vide notification 22/2016 (ST) dated 13.4.2016; certain more services were included in the Mega Exemption which are relevant to mining. Clause 61 of the said notification reads as under:

> *"Services provided by Government or Local authority by way of assignment of right to use any natural resources where such right to use has been assigned by government or the local authority before 1st April 2016:*
>
> *Provided that the exemption shall apply only to service tax payable on one time charges payable in full upfront or in instalments for assignment of right to use such natural resource ."*

As it appears, various representation were made in this regard which led the Ministry of Finance to issue a clarification vide Circular No 192/02/2016 dated 13.4.16 clarifying that exemption contained in Entry no 61 of Notification 22/2016 (ST) shall be applicable only to one time charges & not the periodic payments required to be made. It is further clarified in clause 9 of the circular that, monthly payments with respect to the coal extracted from the coal mines or Royalty payable on extracted coal shall be taxable.

Entry 61 only makes "assignment of right to use natural resources" taxable for the purpose of Service Tax. Clarification given in the circular seeks to enlarge the scope of Entry 61 to include Royalty paid on coal also exigible to tax.

It is requested that the periodic payment made by mines such as Royalty , DMF & NMET in connection with raising of natural resources not being within the ambit of "Service" should be out of levy of Service Tax .

5.2.15. Service Tax on Rentals Paid for Immovable Property

The rental of immovable property constitutes around 50% of total operating cost of retail store. The service tax on rentals paid for immovable property has a huge adverse cost impact on the retail sector since the tenants / lessees are not in a position to avail credit of the service tax.

Appropriate abatement be provided for determining the value of taxable services relating to renting of immovable property on similar lines as provided to several services vide Notification No. 26/2012-Service Tax dated 20th June 2012 amended by Notification No. 8/2014 – Service Tax dated 11th July 2014.

5.2.16. Service Tax – Reimbursements

Finance Act 2015 has included the reimbursements sought by service providers within the definition of "Consideration" for the purpose of determining the value of taxable service. It may be pertinent to note that Clearing & Handling Agents (CHAs), during the course of providing CHA service also make payments for certain expenses, on behalf of service recipient on a Principal to Agent basis and seek reimbursements of the same from the service recipient. The imposition of service tax on such reimbursements adds to the overall cost structure of the exporter. Exporters can seek refund of service tax either on-line at a prescribed rate (as per Schedule of Rates, under Notification No. 41/2012-ST dated 29th June 2012) or seek refund manually establishing the actual service tax suffered by the exporter in the course of export.

The rate prescribed for claiming refunds on-line has not been increased appropriately to cognize for the additional service tax suffered on reimbursements.

Reimbursements claimed by Service Providers purely on a Principal to Agent basis, as above be specifically excluded from the definition of "consideration". Alternately, the prescribed rates (as per Schedule of Rates, under Notification No. 41/2012-ST dated 29th June 2012) be increased appropriately to cover for the incremental cost on account of service tax on such reimbursements.

5.2.17. Unutilized Balance of Education Cess and Secondary and Higher Education Cess

In the budget for the 2015-16, Education cess and Secondary and Higher education cess has been abolished with effect from 1 3 2015. There is no clarification or circular on how to utilize the unused balance of CENVAT Credit of such cesses. Similarly there is no clarity on utilization of the unutilized Education cess and Secondary and Higher education cess on account of input services as on 31 5 2015.

Government should provide for utilization or refund of the outstanding unutilized balance in the cess account immediately. Alternatively Government should incorporate suitable provision in the GST law for transfer of this credit to GST regime.

SERVICE TAX

Clarifications, Procedures and Other Miscellaneous Issues

5.2.18. Reverse Charge Mechanism

The reverse charge mechanism has resulted in:

(i) Significant increase in complexity and cost of compliance in case of corporate bodies in terms of identification of status of service provider, payment of tax per applicable ratio for the specific type of service, maintenance of records, submission of returns, Departmental audits etc.

(ii) Undermining of threshold limits and exemptions prescribed under service tax laws. This is due to the fact that in case of payment of tax under the reverse charge mechanism threshold limits are not applicable, leading to situations where the service recipient, being a corporate body, has to pay service tax in respect of specified services provided by non-corporate service providers even if such service providers are below the prescribed threshold limits.

(iii) Chances of short/excess payment of service tax consequent to differences in understanding of service provider and service recipient on whether a particular service falls under the services notified for taxation under the reverse charge mechanism.

(iv) Scope for dispute and litigation with the Department on interpretation and valuation. For example, whether a particular service is a manpower supply service (to be taxed under reverse charge mechanism) or not would depend on the facts of the case and is open for interpretation.

In an era of growing transparency and simplicity in tax laws the enlargement of list of services under the reverse charge mechanism is a retrograde step and has burdened the service recipient with responsibilities that are rightly those of the Department. In addition to increasing the complexity of compliance, the enlargement of the list of services under the reverse charge mechanism has also diluted the threshold levels prescribed under law since, even if a service provider is exempt from tax by virtue of being below threshold limits, under reverse charge mechanism the service recipient (body corporate in this case) will have to pay the service tax.

To remove this inequity it is suggested that the reverse charge mechanism should be resorted to in rare circumstances. For the sake of administrative convenience it is suggested that the reverse charge be restricted to services provided in India by parties outside India, services provided by non-executive directors to a company and road transportation services provided by GTA. In any case the partial reverse charge should be given up; the tax should be collected in whole either by the service provider or by the service recipient.

5.2.19. Applicability of Service Tax on Reimbursement of Expenses under full Reverse Charge

Finance Act, 2015 has amended section 67 of the Finance Act, 1994 whereby all reimbursement of expenses are also subject to service tax. In case of reverse charge mechanism, the service recipient has to pay service tax on the reimbursements made to the service providers.

The above amendment is leading to double taxation/cascading effect in cases where the service provider cannot take input tax credit for the service provided by him e.g. advocate services. In case of advocate services, which are subject to full reverse charge, the firm providing services may avail certain services and claim reimbursements which may have suffered service tax e.g. hotel bills, travel bills etc. The service recipient has to pay service tax on the total reimbursements made to the advocate which includes the service tax component whereby the service recipient will end up paying service tax on service tax already incurred by the service provider i.e. advocate firm in this case which increases the cost to the service recipients who do not have output service tax liability

It is recommended that suitable amendment be made to the Finance Act,1994 whereby no service tax is payable on the reimbursements which have suffered service tax and input credit against the same has not been availed by the original service recipient (in case of full reverse charge mechanism) who is claiming reimbursement

5.2.20. Point of Taxation - Reverse Charge Mechanism (RCM)

Rule 7 of the Point of Taxation provides that the point of taxation in respect of the persons required to pay tax as recipient under the rules in respect of services notified under sub section (2) of section 68 of the Finance Act,1994 shall be the date on which payment is made. Proviso to Rule 7 of the Point of Taxation Rules provides that where the payment is not made within a period of three months of the date of invoice, the point of taxation shall be the date immediately following the said period of three months.

The raising of the invoice by the service provider and its receipt by the service recipient is not something which is under the control of the service recipients. There may be instances where the invoice is not received by the service recipient within 3 months from the date of invoice. Moreover, it becomes very difficult on the part of the service recipient to track each invoice and the date of its payment especially in case of large corporate assessee.

Considering the fact that without receipt of the invoice within 3 months from the service provider the value of the service may not be determined accurately, service recipient would be made liable to pay interest for no fault on its part and may also be subjected to penal provisions by the Department under the Service Tax laws.

Point of Taxation Rules be amended so as to fix date of payment as the point of taxation in respect of the persons required to pay tax as recipient under the rules in respect of services notified under sub section (2) of section 68 of the Finance Act, 1994 irrespective of the time gap between date of invoice and date of payment.

5.2.21. Service Tax on amount recovered towards Penalty, Fines, Liquidated Damages etc.

As per Sec 66E(e) of the Finance Act, 1994, “agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act” shall be a declared service and liable to service tax. The Central Excise Department in some cases is demanding service tax based on the above provision on the amount recovered as penalty, fine or liquidated damages by the customers from the vendors.

In this context, reference is drawn to the CBEC circular ref no 96/7/2007/-ST dated 23.08.2007 which clarifies that an amount collected for delayed payment of telephone bill is not to be treated as consideration charged for provision of telecom service and therefore, does not form part of the value of the taxable services under section 67 read with Service Tax (Determination of Value) Rules, 2006.

It has also been clarified vide Circular No 121/3/2010- ST dated 26.04.2010 that detention charges collected to hold a marine container beyond the holding period is determined by the shipping companies/steamer agent is not chargeable to service tax, the same being in the nature of a "penal rent" not a consideration for a service.

Necessary clarification should be issued to the effect that liquidated damages, penalties, late fees etc. also do not form part of consideration.

5.2.22. Adjustment of Service Tax paid on amounts Written Off

While the service tax liability is discharged on an accrual basis, in case of bad debts there is no recourse for adjustment of service tax paid thereon. This tax treatment is not fair to the industry as the companies are forced to pay tax without actually earning anything.

It is recommended that the companies should be allowed to adjust the proportionate service tax which could not be recovered against service tax liability for the subsequent period, particularly in cases where due to inherent nature of the business delinquencies are high, relief for bad debts must be allowed.

5.2.23. Manufacturing / Trading of Goods as an ''Exempt Service''

On the basis of the existing definition of service, numerous tax authorities interpret manufacturing/trading of goods as an ''exempt service'' and insist to include value of such services for calculating disallowing credit under Rule 6 of CENVAT Credit Rules. This is an unjust and inequitable position and the definition of service needs to be amended as aforesaid.

Definition of service under Section 65A (44) of the Finance Act, 1994 should be amended to exclude any process amounting to manufacture or production of goods or trading of goods in manner similar to "the activity of transfer of title of goods" which has been excluded from the definition of services.

5.2.24. Place of Provision of Services by Intermediaries

Intermediaries for goods and services providing services to recipients located outside India are liable to service tax based on place of provision of such services as the place of service provider. To ensure that tax on services is ultimately levied in the taxing jurisdiction where the final consumption occurs, the OECD Guidelines prescribe the destination principle. Due to the existing provisions, numerous exports of services are not treated as exports under current regime. Many other countries tax such services as a destination based tax and do not levy tax if customer is located outside their territory.

It is suggested that the place of provision of intermediary service should be location of service recipient.

5.2.25. Technical Testing and Analysis Services

Presently technical testing and analysis services (relating to drugs) provided to overseas customers are not treated as export of services and are subject to tax as the Place of provision of such services is deemed to be in India (Service tax - Rule 4 of the Place of Provision rules 2012).

Since services are provided to a foreign company and foreign exchange is earned on this transaction, this should be treated as export only and hence Rule should be suitably amended to treat such transactions as export of services.

5.2.26. Point of Taxation for Swachh Bharat Cess

Post imposition of Swachh Bharat Cess (SBC) with effect from 15 November 2015, CBEC issued FAQs providing clarifications on levy of SBC including point of taxation. It was clarified to be Rule 5 of the POT rules, 2011. The clarification is misinterpreted to infer that SBC would also be leviable on outstanding balances as on 15 November even if the services have been rendered and invoice issued before 15 November.

Similar issue was addressed for KKC by issuing specific notification. Similar clarification should be provided for SBC as well.

5.2.27. Excess Payment of Service Tax

At present, Rule 6(4A) of the Service Tax Rules, 1994 allows the adjustment of the excess service tax paid by the service provider in the subsequent month or the quarter subject to the monetary limit defined under the Rule. However, there might be a situation, where the excess payment made by the assessee in one month is too high to be adjusted against the service tax liability of the subsequent month. Also, in few cases, the assessee may realise the excess payment made only at the time of filing the half yearly return by when the time of adjustment in the subsequent month or quarter has already gone. In such a situation, the assessee is only left with an option to file the refund claim with the department. This creates lot of administrative hassles for the assessee. Further, Rule 6(3) of the Service Tax Rules, 1994 allows the assessee to suo-moto take the credit of service tax paid by him only in a situation, where the value of the service is renegotiated or the service is not provided at all. It does not provide for availing suo moto credit by the assessee in the above mentioned situations.

It is requested that once the factum of excess payment by the assessee is established, the adjustment of excess paid service tax should be allowed to the assessee without any monetary limit and without restricting it to the subsequent month or quarter only. Alternately, Rule 6(3) of the Service Tax Rules should be amended to allow the assessee to take self-credit in all the situations involving excess payment of service tax.

5.2.28. Valuation of Works Contract

Service Tax (Determination of Value) Rules, 2006 prescribes the portion of value of Works contract to be considered for the purpose of Service Tax payable in respect of an indivisible Works Contract. Similar provisions also exist in the Value Added Tax Acts of several States for determining the value on which VAT is payable in respect of material in the indivisible Works contract. In many cases the taxable base as determined under Service Tax rules and State VAT rules add up to more than the full value of the works contract.

To prevent such anomaly, it is recommended to exclude material portion of the works contract on which VAT has been paid, whether on actual basis or on the basis of deeming provisions in the State VAT laws.

5.2.29. Rebate of Service Tax paid on the Taxable Services

Notification No 41/2012-ST grants rebate of service tax paid on the taxable services which are received by an exporter of goods and used for export of goods. The rebate can be claimed either on the basis of rates specified in the Schedule of rates annexed to the said notification or on actuals on the basis of documents (Actual service tax paid). As per paragraph 1(c) of the notification, rebate eligible on actuals shall not be claimed wherever the difference between the amounts of rebate under the actuals is not more than rebate available under the rates specified in the said notification by at least twenty percent. However, this provision has been misinterpreted by the Department stating that the above condition should be complied with for each and every shipping bill contained in a rebate claim as against the requirement of complying the same at rebate claim as a whole. This view of the Department is causing undue hardship to the exporters as Department has been issuing show cause notices and not processing the rebate claims of exporters.

In order to facilitate ease of doing business, the requirement of paragraph 1(c) of the notification 41/2012-ST should be rescinded and exporters should be allowed unconditionally to claim rebate of the actual service tax paid in relation to the export of goods. Alternately, a clarification may be issued in this regard, instructing the field to process the pending rebate claims as long as the requirements of paragraph 1(c) of the notification have been complied with at a total rebate claim level.

5.2.30. Time Limitation for Issuance of Show Cause Notice for Non-fraud cases

With effect from Budget 2016 the Central Government has increased normal period for issuing SCN in non-fraud cases from 18 months to 30 months in Service tax, which can have wide and far reaching negative impact for the major business houses and diligent taxpayers.

In pursuant to the change in era of automation and technology, when there is a provision for compulsory e-filing of service tax returns and mandatory e-payment of service tax, the extension of time period for issuing SCN does not seem to be prudent. Non-fraud cases mainly occur due to errors while filling in statutory e-returns or making e-payment of service tax or due to pure interpretation issue of the provisions of law. The sole reason behind the introduction of e-filing of service tax returns and e-payment of taxes is that, the Department can immediately scrutinize the same and seek all necessary clarifications if required from tax payers. Therefore there is no necessity for the postponement of such scrutiny of the returns till 30 months.

The time frame for issuance of SCNs for non-fraud cases should be retained at 18 months.

5.2.31. Clarity in Declared Services vs. Deemed Sales

Whether sale of software, works contract, hiring of equipment/vehicles would fall under declared service or under deemed sale is a perennial dispute area. Both the Central and State Authorities are demanding tax on the very same transaction as Service tax and VAT. Even the valuation under each law is overlapping the other. As a result, the tax payer is paying more tax

Clarity is required on taxability and value aspect of these transactions.

5.2.32. Service Tax in Securitization Transactions

Service Tax officers across the country have the predetermined notion that some element of services are embedded in securitization process, but securitization does not involve any service rendition other than the gain of interest. The income which is actually earned from the process of securitization is the ‘’Gain of Interest’’. Interest is not liable to service tax.

Suitable clarification should be issued by CBEC clarifying that no Service Tax would be levied on any financial gain arising to the Originator (i.e. NBFCs) on account of Securitization of any financial assets such as loan, receivables as well as on the assumption/presumption that the NBFCs provide any services on account of securitization of financial asset or receive any consideration for such transactions.

5.2.33. Service Tax on sale of Software and Hardware

As per the present practice, the service tax authorities are charging service tax on both sales of software as well as hardware. While it is evident that the supply of hardware by way of direct sale or by way of transfer of ownership/transfer of right to use, has nothing to do with provision of service. There is no essence of supply of service in the instant situation of supply of IT hardware.

Clarification towards the levy of service tax upon either Sale of software or hardware should be issued.

5.2.34. Abatement provided for Payment of Service Tax on Transportation of Goods by Vessel

Transportation of goods by vessel on import of goods has been made subject to service tax. Further, an abatement of 70% is provided for payment of service tax in such cases.

Generally, shipping companies have contracts with cargo handling companies for transportation of goods rather than having direct contracts with the importer of goods. In such cases, shipping companies charge freight to cargo handling companies who in turn charge this cost from importers.

Clarity is required whether abatement is also available to a cargo handling company on recovery of freight cost from importers as a reimbursement.

5.2.35. Rebate of Swachh Bharat Cess should be aligned with Service Tax Refund

Notification No. 39/2012-ST dated 20 June 2012 as amended vide Notification 03/2016-ST dated 03 February 2016 provides for filing of SBC declaration to claim rebate of Swachh Bharat Cess by service exporters.

Requirement to first file a SBC declaration and then separately file for rebate leads to dual compliances. Secondly, revenue authorities are not familiar with the process to be followed. Therefore, the process should be aligned with service tax refunds. Such alignment would reduce compliances for both the assessees and authorities.

5.2.36. Recognition of Date of Submission of the Return as the Date of Filing

Usually the return is accepted by the ACES portal after 12-24 hours of uploading, leading to rejection of returns uploaded on the penultimate/last date of submission. There are late fees implications on grounds of delay in filing of return due to non-acceptance by the system, which is beyond assessee's control.

It is suggested that once a return is uploaded and "submitted" the same should be considered to be "filed" immediately.

5.2.37. Requirement of Filing Annual Returns

The Union Budget 2016 introduced an additional requirement of filing 2 annual returns (Service tax and CENVAT Credit) by November 30 of succeeding financial year under Rule 7(3A) of Service Tax Rules, 1994 and Rule 12(2)(a) of Central Excise Rules, 2002.

It is not clear that whether annual return is required to be filed by the service provider for the year 2015-16 or whether this amendment is applicable for financial year beginning from April 2016. Further, no format has been prescribed so far for such annual returns. It is not clear that limitation period will be counted from date of annual return or date of half yearly returns. It is also not clear whether date of filing of this return will have any significance while calculating limitation period under section 75 of Finance Act, 1994.

Clarifications may be issued in the context of filing annual returns.

5.2.38. Insertion of "Remarks" Column in Form ST-3

In line with similar column provided in Form ER-1 of Central Excise, a "Remarks" column be inserted in the format of Service Tax Return (Form ST-3) to enable the assessee to provide clarifications / explanations, if required.

CENTRAL EXCISE

Levy and Exemptions

5.3.1. Exemption for Goods used in Sewerage Projects

"Swachh Bharat" being major government initiative and sewerage and sewerage projects are important aspect in Public Health and Sanitation. There is no specific notification providing exemption to goods used for setting up of Sewerage Projects as is available for water supply projects.

It is suggested that the goods / services required for setting up of Sewerage Projects, need to be exempted from payment of excise duty and Swachh Bharat Cess (with its cascading impact) by way of a notification to reduce the cost of setting up of sewerage project.

5.3.2. Inverted Duty structure on Pharmaceutical products

Presently Solid dosage forms are subject to 6% excise duty under chapter 3004 whereas inputs/capital goods/Input services are subject to a higher rate of duty of 12.5%/15%. This leads to a huge accumulated credit in the hands of the manufacturer.

It is requested that input duties on active pharmaceutical ingredients should be brought down to 6%. In view of the impending GST implementation next year, the Government should refund the entire accumulated credit balance instead of allowing the same to be carried forward as the problem may continue under GST as well.

5.3.3. Exemption for items required for R & D Purposes

Presently central excise and customs exemptions are provided to Scientific and research institutions only on specified items vide Notification No 10/97-CE dated 1. 3. 97/Notification No. 51/96-Cus dated 23. 7. 96

This exemption should be extended to all the items used in R&D based on self-certification and approved by DSIR.

5.3.4. Excise Duty on Ethanol for Blending

Government of India has withdrawn last year's notified exemption from excise duty on Ethanol (produced from molasses generated during sugar season 2015-16) for supply to the public sector oil marketing companies (Notification No 12/2012-CE Entry No 40A) vide notification number 30/2016-CE dated 10th August 2016.

Many companies have gone ahead and invested huge sums of money in augmenting the capacity relating to ethanol for supplying to oil companies. The withdrawal has come as a huge shock to the industry. The exemption should be immediately restored.

5.3.5. Concessional Rate of Excise Duty for Motor Starters, Agricultural Capacitors etc.

Motor Starters, Agricultural Capacitors and Submersible Flat Cables, up to certain capacities, are mainly used in the agriculture sector and attract an excise duty of 12%. However, few other products mainly used in agriculture sector are wholly or partially exempted from excise duty.

The excise duty rate of following products, which are mostly used in agriculture sector, be reduced to 6%:

1. Motor Starters for agricultural use / handling water (used for motor power rating up to 7.5 kW / 10 HP or up to Relay range 14-23A etc.)
2. Agricultural Capacitors up to 6 kVAr
3. Submersible Flat Cables up to 6 sq. mm. cross section areas.

5.3.6. Excise Duty on Items of Textile Machinery

Excise duty on all items of textile machinery in general is at 12.5%. The duty on all parts, components and accessories of the textile machinery, in general, is also 12.5%. Excise duty on textile machinery under List 5 is 6%. Excise duty on textile machinery under List 6 is 0%. Excise duty on parts/components of machines under List 6 is 12.5%.

Since the user textile industry does not pay any excise duty, no set off facility is available to them on purchases of textile machinery. As a result the cost of textile machinery increases to that extent. A reduced excise duty of 8% would reduce the burden of the user industry. The machinery manufacturing sector needs support to improve its performance. This will help them to meet the demand and consequently increase their production and would in turn help employment generation.

It is suggested that excise duty on all items of textile machinery should be in general at 8%, there should be no exemption. Excise duty on all parts, components and accessories of the textile machinery in general should be 8%. Excise duty on textile machinery under Lists 5 & 6 should be at uniform rate of 8%. Excise duty on parts/components of machines under List 5 & 6 should also be at 8%.

5.3.7. Excise Duty Benefit for Construction of Transmission Lines

At present there are no benefits in respect of excise duty on the materials used in respect of construction of transmission lines. As transmission lines are meant for transmitting electricity which is required both for domestic and industrial purpose for development of the country, transmission lines need certain concessions / exemptions in the form of excise duty exemption.

5.3.8. Incentives for Non-ODS Technologies

Notification No 12/2012 CE dated 17/3/2012 (S. No 331) allows for exemption from payment excise duty on capital goods required for

1 Substitution of Ozone depleting Substances

2 Setting up New Capacities for Non –ODS Technologies

It is suggested that this exemption is extended to include raw materials/consumables, R&D equipment, testing and calibration equipment.

5.3.9. Exemption for Spent Solvents cleared form EOU

Spent solvents which are cleared form EOU units manufacturing API (Active pharmaceutical ingredients) as waste or remnants are being subject to full rate of Excise duties treating them as by products and concessional duty is not being allowed under notification No 23/2003-CE dated 31. 3. 2003.

Under Foreign Trade policy, waste can be cleared in Domestic tariff area at concessional rate of duties. Hence suitable exemption should be given by the Government to spent solvents which are nothing but waste and cannot be further used in the API manufacturing.

5.3.10. Increase in Value of Excise Exemption Limit for Biscuits

At present lower priced-biscuits (i.e. biscuits sold at a MRP equal to or less than Rs. 100/Kg) enjoy an exemption from central excise duty. The exemption was granted in the Year 2007 taking into consideration that lower priced biscuits are a healthy, hygienic, safe and nutritious staple intended for mass consumption by the lower income strata of the society.

Since 2007 the cost of raw materials used in the manufacture of biscuits (primarily wheat flour, oil and sugar) have more than doubled, along with sharp increase in labour, transportation and energy costs. In the current cost scenario it is increasingly difficult and economically unviable to maintain a sub Rs. 100/Kg MRP for the popular variants of biscuits that are meant for the consumption of the common man is proving to be inadequate to cover a wide variety of biscuits consumed by the masses across the country.

It is recommended that the exemption limit be increased from Rs. 100/Kg to Rs. 125/Kg such that the popular variants of biscuits remain within the reach of the common man.

CENTRAL EXCISE

Procedures and other issues

5.3.11. Time Limit for Sanctioning Refund Claims

Currently, the time limit of sanctioning refund claim is 90 Days from date of filing of refund application. This time period of sanctioning of refund claim is required to be reduced from 90 days to 60 Days. Early sanction of refund claim will help to reduce unnecessary blockage of working capital.

5.3.12. Rate of Interest for Delayed Refunds - Section 11 BB

Under the said Section, the interest on delayed refund is only 6%, whereas interest on delayed payment of duty is starts from 15%. This should be rationalized.

5.3.13. Amount of Pre Deposit for Filing Appeals

Currently to file an appeal it is required to deposit 7.5% at first appellate authority and 10% at second appellate authority. Considering the multiplicity of litigations that happen in a company, there will be significant cash blockage on this account. Therefore, it is suggested that Pre-deposit be brought down to a maximum of 5% at the time of filing an appeal.

5.3.14. Adjustment of Excess duty paid

If any payment of Excise is made in Excess by assessee, there is no provision under Excise to adjust the same and the assessee is left with only option of filing refund for the same.

It is suggested that adjustment of excess payment should be allowed in subsequent month/quarter, similar to provision under the Service tax. Filing of refund creates undue hardship for assessee.

In terms of Rule 8 of the Central Excise Valuation Rules, 2000, where the goods manufactured by assessee are meant for captive consumption at another site, the valuation has to be done based on cost of production calculated as per Cost Accounting Stanadard-4 issued by ICWAI. In such cases, it is not possible for the assessee to compute the actual cost of production and obtain cost certificate from a cost accountant on monthly basis, before each clearance of the manufactured goods. Therefore, the manufacturer has to necessarily resort to provisional assessment and get the same finalised periodically based on the cost audit report & CAS-4 certificate issued by cost accountant. As per the existing law, all cases of provisional assessment have to be finalized by the Deputy/Assistant Commissioner of Central Excise, within a maximum period of 6 months. All the cases where provisional assessment cannot be finalized within 6 months, a request has to be made by the assessee (through Deputy/Assistant Commissioner of Central Excise) indicating the reasons for non-finalization and amount of differential duty for future clearances, before the expiry of the above-said period. For extending the period beyond one year from the date of provisional assessment, the request letter of the assessee has to be put up to the Chief Commissioner in the same manner through Commissioner with his comments.

In the above scenario, it is not possible for the assessee to ascertain the final cost & obtain CAS-4 certificate before the end of the accounting period (i.e. 12 months). In such cases, invariably, the assessees have to make an application to the Commissioner for extending the period of provisional assessment. This poses a practical difficulty for the manufacturer to regularly apply before the Commissioner for extension of period on the same grounds. This increases the paper work for both department as well as assessee.

It is therefore requested to amend Rule 7 of the Central Excise Rules, 2002 to provide that once the permission has been granted by the Commissioner for extension of the period of finalization of provisional assessment, the same would be applicable for the subsequent periods as well unless there is any change in the facts based on which the permission was obtained.

5.3.15. Special Provisions for Commodity Exchange Accredited Warehouses

Commodity Exchanges currently offer online electronic trade in many industrial metals like steel and copper, which are subject to excise duty. Under the Exchange trading system, the commodities deposited into the warehouse may change hands many times (may even be 10 to 15 times) during online trading on the Exchange and before actual physical delivery of goods from warehouse is taken after the expiry of the contract. Due to multiple changes of hands, it may be possible that the ultimate buyer may not receive the goods from the first stage dealer or the second stage dealer. This disentitles the ultimate buyer from availing CENVAT credit of CENVAT duty already paid. Additionally, it may not be possible for the warehouse to obtain separate registration on behalf of each manufacturer/dealer or buyer of goods.

To avoid practical difficulties, the following is requested:

(i) Exchange accredited warehouses may be permitted:

  (a) To obtain registration as a special category of warehouse;

  (b) To receive the goods on behalf of various manufacturers or dealers under a single registration;

  (c) To store the goods received on behalf of various manufacturers at the single premises and co-mingle the same for the purposes of storage;

  (d) To issue excise invoices to buyers obtaining physical delivery of goods.

(ii) CENVAT credit may be allowed on invoices issued by such warehouses.

(iii) The need to issue excise invoices for online trades between the buyers and sellers on electronic platform of national level commodity exchanges may be waived. The above procedure will not result in any loss of revenue since the goods will be under the physical control of the accredited warehouse and will be delivered by the warehouse only after issue of excise invoices to the buyers taking delivery. The accredited warehouse would be bound to comply with all the regulations as may be imposed.

5.3.16. Appropriation under Section 11

Presently department officers sanction refund orders and adjust the same unilaterally against demands which are not confirmed through Adjudication orders. This is incorrect and such adjustment can be made only if the demands are confirmed and after the expiry of the period for filing appeal/stay application.

Even though this issue has been clearly clarified by CBEC in Chapter 18 of the Manual, it is felt that the Section 11 should be amended to clearly state that only confirmed demands can be appropriated against the sanctioned refunds.

5.3.17. Time Limit for Granting Remission of Duty

Remission of duty can be granted by the respective authority of central excise, in case goods have been lost or destroyed or unfit for consumption or for marketing, at any time before removal of goods from the factory. (Rule 21)

To get the remission of duty, the manufacturer needs to make an application with respective jurisdictional Central Excise authority. Currently, there is no time limit defined for granting the remission of duty under the law. Therefore, it is suggested that there should be a prescribed time limit for sanctioning the remission of duty.

5.3.18. Warehousing provision for the Steel Industry

In the steel business, it is a practice that most of the materials are sold from stockyards/depots which are situated across the country and there is a time lag between dispatch of material from the manufacturing plant and sale from the stockyard/depot. As such, there is possibility of a difference in the price prevailing at the time of dispatch of materials from the plant and the price prevailing at the time of final sale of material from the stockyard.

As per Rule 20 of Central Excise Rules 2002, the Central Government may by notification, extend the facility of removal of any excisable goods from the factory of production to a warehouse, or from one warehouse to another warehouse without payment of duty subject to such conditions, including penalty and interest etc. At present this benefit is available to benzene, toluene etc. Steel industries should also be allowed this facility under Rule 20 of Central Excise Rules 2002. This will simplify the existing procedure, as, excise duty will be paid on final selling price from stockyard. This will ensure correct payment of duty and the procedure will be simpler compared to existing practice of paying duty on normal transaction value which may differ from final price. Such change will eliminate disputes relating to valuation at the time of dispatch from plant while, at the same time, achieving the purpose of levy of duty on final selling price.

5.3.19. Automation

In order to get the CT-1 and CT-3, the manufacturer has to file the application with the respective Jurisdictional Officer and on next day they will issue CT-1 and CT-3 certificate. This results in delay in export of goods.

Therefore, it is suggested that these permissions should be made online to avoid any delay in export clearance.

5.3.20. Limits for Remission of Duties

The limits for sanctioning remission by Department officials were last revised in 2007 and it is recommended to increase the same in line with the limits prescribed for issuance of Show Cause Notices.

Sr. No	Designation	Existing Limits	Proposed Limits
1	Commissioner	Beyond 5 lakhs	Beyond 50 lakhs
2	Additional/Joint Commissioner	Up to Rs 5 lakhs	Up to Rs 50 lakhs
3	Assistant/Deputy Commissioner	Up to Rs 1 lakh	Up to Rs 5 lakhs
4	Superintendent	Upto Rs 10,000	Up to Rs 1 lakh

5.3.21. Scope of word "Site"

CBEC vide circular no 1036/24/2016-CX dated 6th July 2016 has clarified that the expression "site" used and defined in notification no 12/2012 C.E. dated 17.03.2012 cannot be used in restrictive meaning. It has also been stated in the circular that field formation in some cases has considered distance as criteria for examining the eligibility of goods for exemption. Circular has clarified that this is an extraneous criteria not flowing from the language used in the notification. On the same subject vide circular no 456/22/99-CX dated 18.05.99 the scope of word "Site" was originally clarified which has now been rescinded vide circular no 1036/24/2016-CX dated 6th July 2016. Further it was also clarified vide circular no 456/22/99-CX dated 18.05.99 that the circular shall also apply to the goods falling under sub heading 7308 of the schedule to the Central Excise Tariff Act, 1985.

In the circular no 1036 dated 06th July 2016, CBEC has provided clarity on the word "Site" against chapter heading 68 and rescinded the old circular no 456/22/99-CX dated 18.05.99 without stating that same shall also be applicable for chapter heading 7308 or 7305. Board has unintentionally rescinded the old circular where the clarity was given against chapter heading 7308 also.

It is suggested that a clarification should be provided that the circular no 1036/24/2016-CX dated 6th July 2016 is applicable mutatis mutandis to the sub heading 7308 & 7305 also to avoid any dispute.

5.3.22. Credit of duty on Goods brought to the Manufacturer's Depot/Stockyard

As per Rule 16 of Central Excise Rules, 2002, where any goods on which duty had been paid at the time of removal thereof are brought to any factory for being re-made, refined, re-conditioned or for any other reason, the assessee shall

be entitled to take CENVAT credit of the duty paid as if such goods are received as inputs under the CENVAT Credit Rules, 2002 and utilise this credit according to the said rules.

As per the above provision a manufacturer can take CENVAT credit of the goods only in case the goods are brought back to the factory. However, there is no provision for bringing back such goods to the depot/stockyard of the manufacturer. A large manufacturing unit operates through number of depots/stockyards situated across the country. Bringing back goods to the factory results in increased expenditure on account of freight cost, if the factory is situated at a long distance from the customer's place.

It is suggested that the existing rule should be suitably amended so that goods can also be brought back to the depot/ stockyard of the manufacturer in such situations.

5.3.23. CENVAT credit on Molasses

Presently rectified spirit (95% Ethyl alcohol) is being treated as non-excisable and thereby CENVAT credit on molasses is denied. Chemical industry manufactures a lot of final dutiable products using Rectified spirit falling under Central excise chapter 22072000 and it is an intermediate product arising in the factory. CENVAT credit cannot be denied on inputs even if intermediate products are exempt from excise duty.

Central Excise tariff entry 22072000 reads as "Ethyl Alcohol and other Spirits, denatured, of any strength". This entry includes rectified spirit as well. Vide office memorandum F No 17/01/2012-Cx.I a stand has been taken that Rectified spirit is non-excisable which is incorrect. This should be withdrawn and suitable clarification issued to hold that CENVAT credit is admissible on molasses which is used in manufacture of rectified spirit (Industrial alcohol) which in turn is used for manufacture of excisable finished products (chemicals).

CUSTOMS

Exemptions

5.4.1. Assessment of Imported Drawings and Designs to Customs Duty and Service Tax

While executing large projects and plants in India, the imported drawings and designs form an indispensable and integral part of the entire project. Generally, such drawings and designs relate to installation of imported as well as indigenous equipment, manufacture of indigenous equipment, undertaking civil and structural work in India, etc.

The drawings and designs are imported in printed form on paper (referred as hard copy), which are used for the aforementioned purposes. Apart from hard copy, the same drawings and designs are also imported in electronic form i.e., on Discs (referred as soft copy), which are used for future reference purpose. There is only one consideration agreed for drawings and designs.

When hard copy is imported, it is classified under Chapter Heading 4911 of Customs Tariff and the consideration for such drawings and designs gets fully and unconditionally exempt from levy of Customs Duty by virtue of Serial no. 275 of Notification No. 12/2012-Cus dated 17.3.2012. The exemption has been in existence from 1994 onwards till date.

When soft copy is imported, the customs department is classifying them under Chapter Heading 85239090 of Customs Tariff and the consideration for such drawings and designs is being subjected to levy of customs duty on the ground that there is no exemption notification for soft copy classifiable under Chapter Heading 85239090.

The above anomalous position is arising due to the fact that drawings and designs are imported in different form through two different media and the customs implication differ based on form of media.

It is considered to be good practice to structure the tariff in a tax neutral manner. In other words, the tax liability or outcome should not vary depending upon the mode of carrying out the transaction. The tax structure should be such that the consequences are same irrespective of the method adopted for undertaking any transaction. This theory and principle has been accepted and applied by CBEC as is evident from TRU Budget Circular dated 29.2.2008, para 4.1.5 which is reproduced below:

> *"4.1.5 Software and upgrades of software are also supplied electronically, known as digital delivery. Taxation is to be neutral and should not depend on forms of delivery. Such supply of IT software electronically shall be covered within the scope of the proposed service."*

In fact, tax neutral approach is foreseen from the manner in which the Information Technology software is treated. Similar tax neutral approach needs to be given to imported drawings and designs. The soft copy should be treated at par with hard copy and hence, no customs duty should be levied on the soft copy as well.

Also, the imported drawings and designs are subjected to service tax on reverse charge basis by virtue of Section 66B read with Rule 2(1)(d)(G) on the ground that the imported drawings and designs received in the form of CD is in the nature of service. It is inequitable and illogical to treat drawings and designs as goods and services at the same time.

It is requested that a clarification / notification may be issued providing that the imported drawings and designs would not be subjected to customs duty and service tax, at the same time.

5.4.2. Customs Duty Exemption on Import of Liquefied Natural Gas (LNG)

Import Duty (Basic Customs Duty) @5% plus cess is applicable on import of Liquefied Natural Gas (LNG). Import of LNG for exclusive consumption in generation of electric energy for public distribution is exempt from customs duty subject to certain conditions. However, other important sectors like fertilizer, LPG, CNG, PNG, and Petrochemical bears the burden of Customs duty @ 5%. The Customs duty increases the landed cost of imported LNG for domestic and industrial consumers. Since the domestic production of Natural Gas is not enough to cater the increasing demand, import of LNG at large scale is required to augment the supply of Natural Gas for use in priority sectors such as Fertilizer, CNG, LPG, PNG etc.

It may be observed that import of 'Crude Oil' is exempt from customs duty. On the same line, it is desirable that import of LNG is exempted from customs duty to enable cost effective supply of gas to important industrial sectors like fertilizer, LPG, CNG, PNG, Petrochemical and power.

It is suggested that LNG Import may be exempted from payment of customs duty (present rate @ 5%) on the lines of crude oil to provide relief to gas based industries and domestic consumers. This will also promote usage of this environmental friendly fuel in industrial and domestic sectors

5.4.3. Duty Free Import of Oil Seeds

India is a large importer of oils & the dependence on imports is only increasing year-on-year.

India has a large capacity for crushing & extracting oil from oil seeds but there is massive underutilization of the same. India is one of the few countries which does not encourage local value addition by keeping the duties on oilseeds (Chapter Id 120100 12079990) at 30% compared to duty on crude oil at 12.5% & on refined oil at 20%. The inverted duty structure is a big disincentive for Indian Manufacturers. Due to the prohibitive nature of duty structure in importing oilseeds, bulk of the imports has been in oil form. We believe that a favourable duty structure for importing oilseeds will help domestic industry, producers as well as consumers.

Globally all the major consumers of edible oil have a duty structure favouring import of oilseeds over imports of oil. This is done in order to make the local crushing industry viable and also to replace imports of De-Oiled cakes with domestic production. The table below highlights the import duties of key edible oil consumers of the world.

Correcting this inverted nature of imported duties in India will go a long way in benefitting industry and consumers alike.

Country	Oilseeds		Oils	
	Soybean	Canola	Raw Soybean Oil	Raw Canola Oil
China	3%	9%	9%	9%
Japan	Duty Free	Duty Free	JPY 10.7/kg	JPY 10.7/kg

The by-product of the oilseed crushing industry is oil cake & de-oiled extraction. This is used as raw material by the Poultry & Cattle-feed industry. Both these industries have been growing at rapid pace making India self-sufficient in our need for mil, milk products & animal based proteins. But now these industries are also facing shortage of raw material due no growth in domestic production of oil seeds.

If the duty on oilseeds is reduced below that on crude oils it will support Make in India and lead to following benefits

- Higher value addition is India & better capacity utilization for domestic manufacturers & higher job-creation in India.
- Better availability of raw materials for the cattle-feed & poultry feed industry thus ensuring better milk & poultry availability in the India & maintaining & enhancing India's global competitiveness in these sectors.
- In case there is a surplus of by-product produced the export of oil-meals & extraction can restart leading to valuable foreign exchange earnings

This will not have an impact on the Indian farmers as imports will shift from one form oil to another form oilseed.

It is our submission to reduce the import duty on oilseeds to zero.

5.4.4. Basic Customs Duty on Goods of Chapter 84 and 85

Rate of Basic customs duty has been increased from 7.5% to 10% on specified tariff lines falling in Chapter 84 and 85. Mechanical and Electrical Machineries, Components thereof are covered under these chapters respectively.

Substation requirements, gas Insulated Switchgear equipment and various other items are being imported frequently. Considering the needs of large infrastructure projects, it is suggested to restore the previous Basic rate of 7.5%.

5.4.5. Customs Duty on Textile Machinery

Effective rate of customs duty on new textile machinery in general is 5%. Similarly Customs duty on all items of parts / components of textile machinery, in general, is 5%. Customs duty on parts of shuttleless looms is nil.

There is enough capacity to manufacture low speed low tech shuttleless looms in the country. However the capacity utilization is only 25%. There should not be any undue advantage to the foreign manufacturer/ supplier of complete machinery. At present there is no level playing field, due to nil duty and export subsidy of 15% enjoyed by the Chinese manufacturers. Further the domestic manufacturers are subjected to local taxes, octroi, sales tax, etc. which are not compensated or set off.

Floor level of customs duty on all items of textile machinery appearing at 8444 to 8451 in general should be 7.5%.

Import duty on some dedicated parts / components of machinery such as compact spinning attachments, drums for Auto cone winding machines which are not made in India so far, should be zero to facilitate manufacturing of high tech

machinery to bridge the technology gap. List of such dedicated components for Shuttleless Rapier Looms (Crank Beat-up and CAM Beat-up), Air Jet and Water Jet Loom, Compact Ring Spinning Frame and Automatic Cone Winding Machine is as follows:-

1	Shedding motion • CAM Dobby, mechanical or electronic • Jacquard mechanical or electronic (600 hooks and above)	84481900
2	Compact Spinning Attachment	84483990
3	Automatic Yarn Splicers for Automatic Cone Winders	84483290
4	Spindle Motor for Automatic Cone Winders	84483290
5	Grooved Winding Drums for Automatic Cone Winders	84483290

The rate of duty on raw-materials, parts, components & accessories should be less than that on complete import of machinery, say by 5%. There should be duty differential between complete machines and the parts/components.

5.4.6. Customs Duty on Project Imports of Cement Plants

Cement industry in India is on a major expansion drive. To boost the industry and reduce project cost, customs duty on Project Import should be reduced.

It is suggested that Basic Customs Duty rate in the case of Project import may be brought down to 2.5% from the current 5%, so that Capital Goods for projects can be imported at concessional duty and thereby reduce project cost.

5.4.7. Incentives for Manufacture of Compressors with Non-ODS Technology

The R134A synthetic refrigeration oil attracts duty of 7.5% as per notification number 12/2012-Customs.

It is requested that this rate of duty may be reduced to 5% as an incentive for manufacture of compressors with Non ODs technology.

5.4.8. Non-availability of Exemption from Duty for Relays

Vide Notification number 10/2015-Customs dated 1.3.2015, the duty on over load protectors and Positive Thermal Coefficient (relays) for use in refrigerator compressors falling under customs tariff head 84143000 was reduced to 5%. However, as only the tariff head of the over load protectors (85362090) is indicated in the notification, the benefit of this notification is being denied by the customs authorities and the consignments of relays are subjected to duty at the tariff rate of 7.5%.

It is suggested that this notification is amended accordingly to include tariff head of relays also.

5.4.9. Rationalisation of High Customs Duty on Import of Private Aircraft

The differential customs duty structure in respect of import of aircraft under Private operations compared to import under Non-Scheduled Operations is impacting the growth of Business Aviation in India.

The aeronautical manufacturing industry in India is in a nascent stage and all aircraft, their components and spare parts are imported. There, is however, a duty on import of aircraft in private category, which is 20.4%, including 2.5% Basic customs duty, 12.5% countervailing duty (CVD), 4% Special Additional duty (SAD) and Education/Higher education cess of 3%. This has resulted in a significant fall in the import of private business aircraft. However, the aircraft imported under Non-Scheduled operations (NSOP) attract only 2.5% basic customs duty, introduced in 2007. This large differential of nearly 18% duty also prompts some private people including corporates to import aircraft under Non-Scheduled

operations route to save customs duty though the intended purpose is to use the aircraft for private use. Similarly, there is a differential duty structure for import of spare parts as well.

The prevailing duty structure is seen to be impeding the growth of this business segment. Admittedly, India has to depend on imports of Helicopters as there is no manufacturer in India from whom they can procure and fulfil their requirement. Thus, tariff or non-tariff barriers are in no way helping protect the domestic manufacturing industry (which is virtually non-existent), as this industry is completely import driven. The need of the hour is a rationalisation of the effective duty structure which does not create any discrimination but on the contrary creates a level playing field for all stake holders.

It also relevant to mention that both DGCA and Customs have found it extremely difficult to institute an effective monitoring mechanism to continuously check the use of aircraft imported under NSOP for private use.

It is opined that a uniform duty structure would ensure desired transparency and eliminate the need for any monitoring resulting in costs savings. This would also be an incentive to import aircraft for private business, thereby increasing the economic activity in Aviation and creation of employment opportunities. It is expected that any revenue loss due to customs duty rationalisation would be offset by additional revenue through direct taxes on account of growth of Aviation.

It is therefore recommended that the duty structure for import of aircraft and parts across categories be aligned/ rationalised, to ensure larger objective of growth of Aviation and ease of doing business.

5.4.10. Exemption for CVD on Specified Machineries used for Construction of Road

S. No. 368 under list 16 of customs notification 12/12, specified equipment for construction of roads was given CVD exemption and now it has been withdrawn. Withdrawal of exemption has resulted in increase in cost of road projects.

It is requested that the earlier complete exemption or at least the CVD exemption may be restored.

5.4.11. Fabric & Garments under Customs Tariff Chapters 51, 52, 54 55 61 & 62

Fabric and garments covered in above stated chapters attract different specific duties of Customs at 8 digit HS code level depending on the fibre content, gram per sq. meter (GSM) of fabric, weave type etc. The difference in the product description under various sub–classifications cannot be determined or identified by physical inspection and requires submission of samples for chemical tests by Textile Committee. This results in inordinate delays in clearance of goods.

The structure of specific duties applicable to goods covered under the aforesaid Chapters should be harmonised and rationalised to obviate the necessity of testing. In the event some testing is found to be essential, test reports from any accredited testing laboratory should be accepted. If necessary, the sample fabric affixed on the test report can be matched with the import consignment.

5.4.12. Relaxation of conditions of Customs Notification No. 102/2007

Notification No. 102/2007- Customs dated 14th Sept 2007, exempts the whole of the additional duty of customs by way of refund provided the goods are imported for sale. While claiming for refund the importer has to produce large volume of VAT invoices.

Since production of such huge volumes of document creates hardship this condition may be relaxed. Ironing these anomalies will certainly yield great relief to the Trade and Industry. We suggest that such refunds should be allowed based on an independent Chartered Accountant’s certificate in this regard.

Further, considering that the intention of the notification is to benefit exporters, the provisions of unjust enrichment should specially be made as not applicable.

CUSTOMS

Procedures and other issues

5.4.13. Harmonisation of Customs Value and Transfer Pricing

Customs valuation for imported goods and Transfer Pricing under Income Tax laws are based on arm's length principle, whose objective is to ensure that taxable values of imports are correct and taxes are paid appropriately on arm's length value. However, intention under both the regulations drives in opposite directions i.e. the Customs tend to increase the import value of goods to increase tax while the Income tax department attempts to reduce purchase price of imported goods to increase taxable profits. The diverse end-results create ambiguity and uncertainty in pricing.

There is a need for harmonization between these two sets of conflicting legal provisions. Guidance may be provided for acceptability of transfer prices/import value by one arm of the Government, in case the other arm had accepted the price at arm's length.

5.4.14. Amendment of Bill of Entry Format

Whenever the material imported by the principal is required to be directly supplied to Loan Licensee (Job worker), bills of entry are endorsed by the principal to enable the Loan Licensee manufacturers to take CENVAT credit on the endorsed bills of entry. The said practice has been challenged by the department stating that endorsed bill of entry is not valid document specified under CENVAT Credit Rules, 2004 as there is no name of Loan Licensee manufacturer mentioned on Bill of Entry.

Therefore it is suggested that provision be made in the Bill of Entry format for indicating the details of the consignee (end user receiver – Loan Licensee) of the goods in addition to the details of importer.

5.4.15. Time Period for Production of Installation Certificates under EPCG Scheme

Para 5.3.1 of Handbook of Procedures (Vol.1) of Foreign Trade Policy, provides for the submission of Installation certificate from Jurisdictional Excise officer in respect of items procured under EPCG license confirming installation of Capital Goods within six months from date of completion of import.

Customs Circular No.14 /2008 dated 26.09.2008 also provides that the Authorization holder under the EPCG Scheme shall produce to the concerned Regional Authority, a certificate from the jurisdictional Central Excise Authority, confirming installation of capital goods at factory premises of Authorization holder within six months from the date of completion of imports.

In large manufacturing companies, Installation of Capital equipment requires assembling various resources and expertise and is dependent on various activities like, site clearance, civil work, structural work, availability of shutdown, safety preparation in unsafe site conditions, etc. Installation of capital equipment starts only after completion of these pre-requisite activities. Delay in any of these activities will have adverse impact on schedule of installation of capital equipment. In many cases the time taken in installation of capital goods exceeds six months. Although, there is a provision for extension of time for installation of equipment but it requires time and efforts in following the procedures related to obtaining extension of time.

In view of the situations mentioned above it is requested to specify the initial limit for installation of capital items as 12 months instead of the existing 6 months with a provision for seeking further extension.

CENVAT CREDIT

5.5.1. Accumulation of CENVAT Credit

An inverted duty structure refers to a situation where manufacturers have to pay a higher duty on raw material while the resultant finished product attracts lower duty. In the absence of a duty refund mechanism, this coupled with service tax credit, which a manufacturer is entitled to as a service receiver, results in accumulation of credits over a sustained period of time. This is more acute where the manufacturer sources most of his raw materials from abroad and value addition on finished product is not very high.

As an example, on import of intermediate raw materials, a Company claims 17.74% credit on Customs Duty while the corresponding finished product is charged to 12.36% duty. This means that to fully utilize the credit, Company has to have a value addition of at least 45%. After taking into account the service tax credit, the accumulation gets even higher with no corresponding liability to set-off. Similarly in pharmaceutical industry, the input/input service and capital goods credit comes at higher rate of 12.5% in case of Central Excise and 14% in case of Service Tax; whereas the final product that is medicaments attract duty of 6%.This results in significant blockage of working capital funds and therefore entails higher interest cost to carry on business in India.

A legal provision to refund such unutilized credit at the end of every financial year will bring relief to all such manufacturers and will act as a catalyst for encouraging Investments in setting up manufacturing facilities in India.

5.5.2. Reversal of CENVAT Credit taken on Inputs/Capital Goods Written off in Account Books

As per Rule 3 (5B) of CENVAT Credit rules 2004, if the value of any input or capital goods before being put to use, on which CENVAT credit has been taken is written off fully or partially or where any provision to write off fully or partially has been made in the books of account, then the manufacturers or the service providers as the case may be, shall pay an amount equivalent to the CENVAT credit taken in respect of the said inputs or capital goods.

It is practically not possible to exactly work out the CENVAT credits attributable to such inputs or capital goods, for which provision to write off fully or partially is made in the books of account. Such inputs or capital goods (like tools, jigs, fixtures, inserts, machinery spares etc.) may be in inventory since many years and no CENVAT records will be maintained, if it is beyond 5 years.

In spite of the manufacturers/ service providers reversing the CENVAT credit at higher rate of duty also, the department is not willing to accept the same and they are literally going by the rule that only the exact CENVAT credit attributable to such inputs or capital goods alone to be reversed.

It is recommended that the Government should look into this from the view point of practicality, compliance and also ensure no revenue loss by way of suitable provision to Rule 3 (5B) of CCR 2004 or by substituting the said rule, giving the best options to the manufacturers or service providers to comply, without much complication and dispute in the interest of Trade and Industry on one hand and Revenue on the other hand. If not addressed this immediately, there will be lot of disputes/ litigations, which is not called for in the interest of both the Revenue and the Assessees.

A stipulation on the following lines could be considered:-

In the absence of linking up to the CENVAT documents to arrive at the exact duty credit attributable to such inputs or capital goods written off fully or partially, the manufacturer shall pay an amount equivalent to ……% on the value of such goods written off OR shall pay an amount calculated at the prevalent rate of duty applicable on the date of making such provisions in the books of account.

5.5.3. Depreciation Norms for Information Technology & Telecom Hardware Products

The rate of depreciation granted in respect of Information Technology & Telecommunication Hardware Products (IT) products (i.e. products other than computers and computer peripherals) is neither synchronized nor commensurate with the pace of technological advancement and consequent obsolescence. Further, the scope and range of IT products eligible for accelerated depreciation under income tax and customs and central excise laws is limited and restricted. FICCI would seek broad-banding of the list of IT products eligible for accelerated depreciation and further request for an increase in depreciation rate for IT products.

The provisions relating to rate of depreciation for IT products other than computer and computer peripherals under the provisions of Foreign Trade Policy read with Notifications issued by CBEC (as applicable for STP units), Special Economic Zone Act read with rules thereunder, CENVAT Credit Rules and Income-tax Act are as follows:-

A. Depreciation Norms under the Foreign Trade Policy

Notification 22/2003- CE dated March 31, 2003 and Notification 52/2003 - CUS dated March 31, 2003 which extend excise duty and customs duty benefits respectively to units under the Software Technology Parks of India (“STPI”) provide for depreciation of goods as mentioned below:

(a) For computer and computer peripherals

For every quarter in the first year	*10%*
For every quarter in the second year	*8%*
For every quarter in the third year	*5%*
For every quarter in the fourth and fifth year	*1%*

(b) For capital goods other than computer and computer peripherals

For every quarter in the first year	*4%*
For every quarter in the second year and third year	*3%*
For every quarter in the fourth and fifth year	*2.5%*
For every quarter for every year thereafter	*2%*

As evident from the same, IT products other than computers and computer peripherals would achieve full depreciation only after a period of 10 years.

B. Depreciation Norms under Special Economic Zone Act read with Rules thereunder

Rule 49 of the Special Economic Zone Rules, 2006 (“SEZ Rules”) provides for removal of goods to domestic tariff area from a Special Economic Zone on payment of duty. Such duty needs to be calculated on value after providing for depreciation as mentioned below:

“(c) depreciation shall be allowed in straight line method as specified below, namely-

(i) for computer and computer peripherals for every quarter in the first year at the rate of ten per cent. for every quarter in the second year at the rate of eight per cent. for every quarter in the third year at the rate of five per cent. for every quarter in the fourth and fifth year at the rate of one per cent.;

(ii) for capital goods other than computer and computer peripherals for every quarter in the first year at the rate of four per cent. for every quarter in the second year at the rate of three per cent. for every quarter in the third

year at the rate of three per cent. for every quarter in the fourth and fifth year at the rate of two and half per cent. and thereafter for every quarter at the rate of two per cent."

As evident from the same, IT products other than computers and computer peripherals would achieve full depreciation only after a period of 10 years.

C. Depreciation Norms under the CENVAT Credit Rules, 2004

The rate of depreciation prescribed in respect of capital goods (other than computer and computer peripherals) as provided under the CENVAT Credit Rules, 2004 (the "CENVAT Rules") is very low. For IT products (other than computers and computer peripherals) to achieve full depreciation, would entail a lapse of 10 full years. Relevant extract of the provision is as follows:

"3(5A)(a) If the capital goods, on which CENVAT credit has been taken, are removed after being used, whether as capital goods or as scrap or waste, the manufacturer or provider of output services shall pay an amount equal to the CENVAT Credit taken on the said capital goods reduced by the percentage points calculated by straight line method as specified below for each quarter of a year or part thereof from the date of taking the CENVAT Credit, namely:

(i) for computers and computer peripherals:

For every quarter in the first year	*4%*
For every quarter in the second year and third year	*3%*
For every quarter in the fourth and fifth year	*2.5%*
For every quarter for every year thereafter	*2%*

(ii) for capital goods, other than computers and computer peripherals @ 2.5% for each quarter."

As evident from the above, the rate of depreciation under Rule 3(5A) of the CENVAT Rules for ITA products (other than computer and computer peripherals) is 2.5 percent per quarter which amounts to 10 percent per year which is very low considering that ITA products and computers and computer peripherals have an identical life cycle.

D. Depreciation Norms under the Income Tax Act, 1961

In terms of Income Tax Act, 1961, *"computers including computer software"*, is eligible for depreciation of 60 percent per annum on the written down value.

However, other IT products are eligible for lower depreciation rates depending upon their usage/ treatment by manufacturers/ service providers.

A perusal of the same would reveal that the rate of depreciation is abysmally low. Further the benefit of accelerated depreciation is currently confined to *"Computers and computer peripherals"* (under indirect tax laws) and *"computers including computer software"* (under income tax law). In light of the narrow scope of the descriptions above, significant number of IT (including networking equipment and storage systems) do not enjoy the intended accelerated rate of depreciation. It is important to note that most IT products (especially all ITA bound items) have approximately the same, if not shorter, life cycle as "computers and computer peripherals". Even the current rate of accelerated depreciation prescribed is not sufficient keeping in mind the pace of technological obsolescence. Pertinently, the average useful life-span for most IT and telecom hardware including computers and their peripherals is presently between 2 and 4 years. As opposed to their actual life-span which is less than 5 years, the legal provisions envisage their depreciation over a period of 5 years for computers and computer peripherals and over a period of 10 years for other IT hardware (especially under indirect tax laws).

Recommendations

- It is recommended that the expression “Computer and computer peripherals” be replaced with the expression “information technology and telecommunication hardware” in the following provisions:
    - (a) Notification 22/2003 – CE dated March 31, 2003
    - (b) Notification 52/2003 – CUS dated March 31, 2003
    - (c) Rule 49(1)(c)(i) of Special Economic Zone Rules, 2006
    - (d) Rule 3(5A)(a)(i) of the CENVAT Credit Rules, 2004
    - (e) Depreciation schedule under Appendix I to the Income Tax Act, 1961
- Further to the same, a comprehensive list of IT and telecommunication hardware eligible for accelerated depreciation may be specified in the respective notifications, CENVAT Rules as well as income tax depreciation schedule by making a reference to the ITA goods list contained under Notification No 24/ 2005 – Customs and Notification No 25/ 2005 – Customs both dated March 1, 2005.
- This amendment would ensure that key IT and telecommunication products (i.e., ITA bound items), that are prone to frequent obsolescence, enjoy an accelerated depreciation rate in comparison to the depreciation rate prescribed in respect of other capital goods under the income tax as well as indirect tax laws.
- It is further suggested that the accelerated depreciation rates prescribed for ITA goods be increased to reflect the current reality; and in this regard, the rate of depreciation may be revised to *10 percent per quarter or part thereof* under the following provisions:
    - (a) Notification 22/2003 – CE dated March 31, 2003
    - (b) Notification 52/2003 – CUS dated March 31, 2003
    - (c) Rule 49(1)(c)(i) of Special Economic Zone Rules, 2006
    - (d) Rule 3(5A)(a)(i) of the CENVAT Credit Rules, 2004
- Given that under IT Act, the depreciation provided is 60% on the tax written down value, full depreciation in respect cannot be achieved even in 4 years time. Prescribed depreciation rate under IT Act is not in tune with the advancement in technology (although the rate of depreciation for IT products is among the higher rates, certain other assets such as books are entitled to depreciation at the rate of 100%).

  To illustrate, under the current provisions of the IT Act, in case an item which is licensed for three years is capitalized for tax purposes, the same is depreciated for a period of more than 3 years on account of the same forming part of a block of assets and considering the lower rate of 60% applicable in relation to IT products.

  Therefore, it is recommended that the rate of depreciation in relation to computers, software and other IT products (i.e. all ITA goods) be increased from the existing rate of 60% to a rate of 90% which would then bring an increased correlation between the tax depreciation and the usage of such IT products. This would also reasonably align the period of depreciation for income tax purpose with that under indirect tax laws.

5.5.4. Scrutiny of Distribution of Common Services by ISDs

In case of distribution of common services by Input Service Distributor, assessment/verification of CENVAT credit is done by tax authorities of the units to which these credits are distributed.

This practice leads to duplication of work at all units as while the location of the Input Service Distributor is subjected to detailed audit, the locations where the credit has been distributed are once again subjected to audit.

It is suggested that , the Government should clarify that jurisdiction for CENVAT credit of input services distributed under Rule 7(d) i.e. common services is the location of transferor i.e. Input Service Distributor and not the transferee i.e., the location to which the credit is transferred. Based on the audit conducted on the ISD, SCN may be raised on the location where the credit has been distributed through their Jurisdictional Range.

5.5.5. Restrictions on Input Tax Credit

Implementation of the concept of Negative List of Services has resulted in all activities undertaken by a person for another for a consideration being brought under the tax net. However, the restrictions, exceptions and limitations on availability of input tax credit still continue. This anomaly has led to an inequitable situation whereby the taxation of services is universal while the credit for the tax paid on input services continues to be restricted.

In order to correct this inequity and to provide much needed relief to industry the service tax laws in general and, specifically, the definition of input service should be amended to allow input tax credit without any restrictions – in line with the principles of GST. Further, in order to ensure that the CENVAT Credit scheme meets its objectives it is important that unnecessary qualifications/categorizations like ‘input’, ‘input service’ and ‘capital goods’ be done away with and all input side tax costs in relation to business activity should be allowed as credit.

5.5.6. Accumulated CENVAT Credit of Supplies on Deemed Export Basis

Government provides benefit to Mega Power Project on procurement of machinery, equipment and construction materials etc. without payment of excise duty under deemed export benefit. Most of the construction materials and parts of machinery are supplied by MSME Sector. They procure input materials on payment of duty and they have taken CENVAT Credit. But their clearance is exempted for duty payment against project authority certificate under deemed export. Therefore their CENVAT credit is getting accumulated day by day resulting in blockage of funds and shortage of working capital. There is no clear provision for getting cash refund of accumulated CENVAT under Deemed Export Project under International Competitive Bidding.

It is suggested that deemed exports should also get the same status as physical exports for getting cash refund under Rule-5 of CENVAT Credit Rules, 2004.

5.5.7. CENVAT Credit on Input & Capital Goods installed outside Factory Premises

As per Rule 2(a)(A)(1) of the CENVAT Credit Rules, 2004 the CENVAT in respect of Capital Goods can be availed, when it is used in the factory of manufacturer of the final products. Further, Rule 2(a)(A)(1a) also extends the eligibility of CENVAT on the Capital Goods used outside the factory of manufacturer of the final products, when the same is used for generation of electricity for captive use within the factory.

Similarly, as per the Rule 2(k)(i) of the CENVAT Credit Rules , 2004 , CENVAT credit of “input“ is available on the goods used in the factory of manufacturer.

A large manufacturing unit is required to undertake installation of certain Capital goods / Inputs outside the factory without which it is not possible to carry out the manufacturing process. Some examples in this category are laying of railway tracks outside factory which is interconnected with railway tracks for bringing raw materials inside the factory. Similar is the case of pumping stations, water pipelines, etc. installed outside factory which helps in continuous supply of water to the plant which is required in manufacturing process.

Suitable amendment may be made in this regard so that credit can be availed for Capital Goods / Inputs which are installed outside the factory premises for supplying essential raw material /utilities to the plant for enabling manufacturing.

5.5.8. Obligation of a Manufacturer in case of Clearance of By-product/Waste/Refuse

As per Rule 6 of CENVAT Credit Rules, 2004, the CENVAT Credit shall not be allowed on such quantity of inputs used in relation to the manufacture of exempted goods. In many manufacturing process unintended emergence of by-products takes place. As per the recent decision of Honorable Supreme Court in the matter of M/s Hindustan Zinc Ltd vs Union of India (2014-TIOL-55-SC-CX), provision of Rule 6 of CENVAT Credit Rules is not applicable in the case of by-products.

It is suggested that a clarification in this regard should be issued to avoid unnecessary dispute.

5.5.9. Availment of CENVAT credit for Banking and Finance Sectors

A doubt has been raised as to whether in terms of the provision of Rule 6(3B) of the CENVAT Credit Rules, availing of 50% of the credit at the very inception stage and charging the balance 50% to the Profit and Loss account as expense, is correct and precise and is in compliance to Rule 6(3B) of the CENVAT Credit Rules. Further clarification is required as to whether the present practice gives due effect to the theme and spirit of the provision as laid down as per Rule 6(3B) of the CENVAT Credit Rules.

In the absence of such clarification at present the various assesses under Banking & Finance Sector are following different methodology towards the compliance of Rule 6(3B) of the CENVAT Credit Rules. There should be specific circular / guiding provision governing the precise procedure through which such CENVAT credit reversal should be made.

5.5.10. Availment of CENVAT Credit on Capital Goods

As per Rule 4(2) of CENVAT Credit Rules, 2004 only 50% CENVAT credit is allowed on capital goods in year of purchase and balance 50% in subsequent years. This results in cash flow problems. Moreover, elaborate accounts need to be maintained to keep track of the credit availed.

CENVAT Credit Rules be amended to allow 100% CENVAT credit on capital goods in the year of purchase itself.

5.5.11. CENVAT Credit on Capital Goods used outside the Factory for handling of Raw Material

Fly ash, waste product of power plants, presents a major challenge in their safe environmental disposal. Cement plants by using this waste product as a raw material in the manufacture of Cement greatly contribute crucially in preventing environmental damage. However, for handling of Fly Ash, Cement plants have to install "Handling System" at the premises of power plants by investing in purchase of various Capital goods. As the Capital goods are used outside factory of the manufacturer, these do not qualify as Capital goods under Rule 2(a) of the CENVAT Credit Rules, 2004.

It is pertinent to note that the definition of capital goods has been amended from time to time considering the industry requirements. Therefore by the amendments effected by Budget 2011-12 Capital goods installed outside the factory for generation of electricity for captive use within the factory have been specifically included in the purview of capital goods and CENVAT credit of the duty so levied by the manufacturer has been allowed. Similarly, Capital goods used for Fly Ash handling system installed at supplier (Power Plants) premises also equally play a key role in manufacturing of Cement. Therefore, CENVAT Credit of the excise duty paid on Capital Goods should also be allowed.

It is suggested that the definition of the term Capital Goods should be amended to include Capital Goods used outside factory and used in relation to manufacturing of final products or for handling & transportation of raw materials, intermediate products and final products.

5.5.12. Removal of Capital Goods after Use

Rule 3(5A) of CENVAT Credit Rules 2004 allows a manufacture/ provider of output service to remove any capital goods after being used with a payment equal to CENVAT credit taken on the said capital goods reduced by @ 2.5% for each quarter or part of thereof from the date of taking CENVAT credit.

As most of the cases, such removals are on account of spares, a higher rate of deduction say @ 5% per quarter is proposed.

5.5.13. Denial of CENVAT Credit for R&D Operations outside the Factory

Presently CENVAT credit is being denied by Excise department on input services which are used in in house R&D centers located outside the factory of Pharma companies which are transferred to manufacturing locations through input service distribution mechanism.

Suitable clarification be issued to allow the credit on such cases as ultimately the in house R&D activities are linked to the manufacturing activities. Merely because they are located outside the factory, credit should not be denied.

5.5.14. CENVAT Credit on Wagon Rakes used for Material Handling

Cement industry operates in huge volumes and therefore uses wagon rakes for material handling and transporting the cement/raw material in bulk from its mother manufacturing plant to its packing plant.

Since Wagon is classified under chapter heading 86 of the Central Excise Tariff Act (CETA), it does not qualify as capital goods, as defined, as per Rule 2(a) of the CENVAT Credit Rules, 2004. Therefore, although wagons aid in material handling and transportation of raw materials in bulk within its manufacturing plants, on account of the said restriction the industry is denied the benefit of considerable amount of CENVAT Credit of excise duty levied by the manufacturers of this goods.

Considering the industry and the role of Wagons rake in material handling, it is pertinent to note that the definition of capital goods has been amended from time to time considering the nature of industry and the role they play in the same. In the Union Budget 2012-13, Dumpers and Tipplers have been specifically included in the purview of capital goods by amending CENVAT Credit Rules. Like, dumpers and tipplers, Wagon rakes also aid in material handling system. Therefore, CENVAT Credit of the excise duty may also be allowed on the same.

It is suggested that the definition of the term Capital Goods may be amended to include Wagon Rakes and Parts thereof without any condition of its being used within the factory of production.

5.5.15. CENVAT Credit of Inputs used in Manufacture of Specified Exempted Goods

At present items supplied to Research institutions under the administrative control of Government of India are exempt from payment of excise duty under Excise Notification No. 10/97 Dt. 01.03.97 and items supplied to Defence Department are exempt from payment of excise duty under Excise Notification No. 64/95 Dt. 16.03.95. As per Rule 6 of the CENVAT Credit Rules, 2004 CENVAT Credit of goods used for manufacture of final product which is exempted from payment of excise duty is not allowed. This results into additional cost to the Indian manufacturer whereas foreign supplier by availing Customs Duty Exemption Certificate supplies equipment to Ministry of Defence with NIL Customs Duty.

At present supplies to power project, Solar Power Projects, SEZ, EOU, Exports etc. are exempted from Excise duty. However, in all these cases CENVAT credit on Inputs and Input services are allowed even if final product is exempt from payment of excise duty. This exemption is provided in Rule 6(6) of CENVAT Credit Rules, 2004. We suggest that the Rule 6(6) be amended by adding sub clause (ix) and (x) as under:

"(ix) Supplies of goods to Research institutes under administrative control of Government of India under Excise Notification 10/97

(x) Supplies made to Ministry of Defence / Ministry of Space under Excise Notification 64/95."

5.5.16. Reversal of CENVAT Credit pertaining to Exempted Service

The Finance Act, governing the Service Tax requires reversal of CENVAT Credit availed during a financial year against input or input services if they are used to provide both exempted and non-exempted services. To compute the reversal of CENVAT Credit, a service provider has to choose one of the following two options; namely

a) 7% of value of exempted services; or

b) Common credit attributable to exempted services based on prescribed formula.

This was applicable only to the specified services such as services to J&K, SEZ etc. that were exempted from levy of Service Tax under the Finance Act 1994.

In the Union Budget 2016, the scope of "exempted service" has been expanded by amending the said definition. Under the new definition, any activity which does not fall within the definition of 'service' but for which input or input services are used is regarded as 'exempted service'. There are common credits such as establishment cost, audit fee etc. which would be incurred for all services, including for 'exempt services'.

Basis discussions with CBEC, such change was intended to tap the real estate companies, which were claiming CENVAT Credit on disproportionate basis as certain activities of sale of real estate was outside the ambit of output service tax. However, the way the current law has been drafted, all activities which were never considered as 'service', such as treasury income, dividends etc. have become 'exempted service' thus requiring proportionate reversal of CENVAT Credit. This seems to be an unintended anomaly, which would adversely impact across different sectors and industries and create unintended and undesired burden across all industries.

To elaborate further with an example (and there could be many such genuine hardships), there are treasury activities and investments (including strategic investments and investments in subsidiaries) that result in income such as dividends, share sale etc. The way the section has been amended by Finance Act 2016, dividend and share sale could be regarded as "exempted service", requiring the reversal of significant value of CENVAT Credit, when in fact no / marginal CENVAT Credit has been availed for earning dividend income / sale of shares. The burden and hardship gets exponentially increased because of the fact that the assignment of spectrum and revenue share license fee has been made liable to service tax by the Finance Act 2016, thereby increasing the pool of CENVAT Credit. Consequentially, a significant value of reversal of CENVAT Credit may happen on account of dividend / sale of shares like streams of income, when in fact CENVAT Credit on spectrum / license fee is in no way remotely connected with the dividend income. This would significantly increase the cost of doing business. For sake of completeness, interest from loan, advances and deposits is still kept outside the ambit of exempted service for the purpose of CENVAT Credit reversal.

It is requested that treasury activities such as dividend / sale of shares should also be kept outside the ambit of CENVAT Credit reversal, like the same as interest income. In the alternate, an appropriate clarification be issued to clarify that the CENVAT Credit used exclusively and directly for such activity (dividend income / sale of shares) should only be required to be reversed. This will go a long way in removing the undesired burden and hardship that seems to have been created possibly due to an unintended drafting anomaly in law. A clarification in this regard would go a long way in significantly improving India's image in ease of doing business.

5.5.17. Amendment of Bill of Entry Format

Whenever the material imported by the principal is required to be directly supplied to Loan Licensee (Job worker), bills of entry are endorsed by the principal to enable the Loan Licensee manufacturers to take CENVAT credit on the endorsed bills of entry. The said practice has been challenged by the department stating that endorsed bill of entry is not valid document specified under CENVAT Credit Rules, 2004 as there is no name of Loan Licensee manufacturer mentioned on Bill of Entry.

Therefore it is suggested that provision to be made in the Bill of Entry format for indicating the details of the consignee (end user receiver – Loan Licensee) of the goods in addition to the details of importer.

5.5.18. Utilization of Education Cess & Secondary Higher Education Cess

As per Notification No. 14/2015–CE and 15/2015–CE both dated 01.03.2015, levy of Education Cess and Secondary & Higher Education Cess has been removed. This amendment became applicable from 1st March, 2015. The education cesses on service tax were also withdrawn from June 1, 2015. However, the manufacturers are left with balances of these cesses in their CENVAT accounts which remain unutilized.

As per Rule 3(7) (b) of the CENVAT Credit Rules, 2004, CENVAT credit of specified duties shall be utilized for payment of those specified duties only. In other words, CENVAT Credit of Education Cess and Secondary Education Cess can be utilized respectively for payment of Education Cess/Secondary Education Cess only.

Vide notification no 12/2015-Central Excise (N.T.), dated April 30, 2015 Rule 3(7)(b) was amended to provide that the credit of Education Cess and Secondary and Higher Education Cess paid on inputs or capital goods received in the factory of manufacture of final product on or after the 1st day of March, 2015 can be utilized for payment of the duty of excise. Similarly credit of Education Cess and Secondary and Higher Education Cess paid on input services received by the manufacturer of final product on or after the 1st day of March, 2015 can be utilized for payment of the duty of excise

However, there are many cases where the material and services are received in the factory before 1st March 2015 but the credit has been availed after 1st March 2015.

This aspect has not been considered in the notification and hence it is not clear as to whether the CENVAT credit on Education Cess and Secondary & Higher Education Cess availed on the inputs, capital goods and input services received before 1st March 2015 can be utilized for payment of excise duty after 1st March 2015.

It is suggested that CBEC should issue a clarification/amendment and allow the utilization of CENVAT credit on Education Cess and Secondary & Higher Education Cess availed on material and services received before 1st March 2015 for payment of Central Excise duty.

5.5.19. Credit Availment in case of Works Contract

Service Tax (Determination of Value) Rules, 2006 provide for restriction on availment of CENVAT credit belonging to inputs (Explanation 2 to Rule 2A).

Such restriction is unreasonable especially when the contractor is following the valuation under actual method. Even in case of abatement method, the credit should be allowed. In comparison with VAT laws, where similar valuation methodology is followed, credit is restricted only in case of composition scheme. There is no restriction when actual method or abatement method is followed. But in service tax, there is no composition scheme as on date. Therefore, the credit on inputs should also be available. This would provide a fair methodology to the assessee.

5.5.20. Definition of Exempted Goods as per Rule 2(d) of CENVAT Credit Rules, 2004

There are instances of department demanding payment of duty or amount under rule 6(3) of CENVAT Credit Rules, 2004 on goods on which job work is carried, treating the same as 'exempted goods' which is unwarranted.

Goods manufactured by a job worker are exempt from payment of whole of the duty of excise under Notification No. 214/86 CE subject to the condition that the Principal Manufacturer (supplier of raw materials or semi-finished goods) uses the job worked goods in or in relation to the manufacture of the final products in his factory or removes from his factory without payment of duty in specified cases.

It is suggested that the definition of 'exempted goods' in rule 2(d) be amended to clarify that goods produced or manufactured on job work basis where the principal manufacturer is under the obligation to pay duty on such goods

will not be construed as 'exempted goods'. This would avoid multiple incidence of duty on the same goods and avoid unnecessary litigation.

5.5.21. Transfer of CVD Credit to another Unit

Rule 10A of the CENVAT Credit Rules, 2004 allows transfer of CENVAT credit of additional duty leviable under Section 3(5) of the Customs Tariff Act to another excise registered premises of the same manufacturer having common PAN. However there is no such provision for transfer CENVAT credit of CVD which is levied under Section 3(3) of the Customs Tariff Act.

Provision should be made in the CENVAT Credit Rules allowing transfer of CVD to another excise registered premises in the same line with additional duty of Customs. This will help working capital management of the assessee to a great extent.

5.5.22. CENVAT Credit Rules - Explanation 3 to Rule 6 of the CENVAT Credit Rules

Budget 2016 inserted an Explanation 3 to the Rule 6(1) of the CENVAT Credit Rules, 2004. The explanation states that exempted services as defined in clause (e) of rule 2 shall include an activity, which is not a service as defined in section 65B(44) of the Finance Act, 1994 provided that such activity has used inputs or input services. In a case of a manufacturer selling the goods (wherein transfer of property in goods is involved), as per the new explanation inserted it could get covered as exempted service resulting into excess reversal of CENVAT.

It is suggested that the explanation be withdrawn.

5.5.23. CENVAT Accumulation for Metal Cans Supplied for Export of Goods

The metal container industry is suffering due to CENVAT accumulation on account of sales to merchant exporters who buy goods under Notification 43/2001 where no excise duty is charged to them. Various food products like mango pulp, process vegetables, coffee etc. which are packed in tin containers are exported out of the country by manufacturers, export house, traders, merchant exporters etc. These cans are supplied by the industry without paying excise duty under Notification 43/2001 dated 26/6/2001 as merchant exporters and their supporting manufacturers don't want to pay excise duty and claim refund. The said notification stipulates "procurement of goods without payment of duty for the purpose of use in the manufacture or processing of export goods and their exportation out of India". For can making industry, this results into underutilization of CENVAT credit. We suggest that such deemed export should be brought at par with physical export as in the latter case, the excise duty paid on packaging material is being refunded under Rule 18 of the Central Excise Rules 2002. The above measure would help the industry to address the issue of accumulation of credit which is causing huge cash flow problem to them.

It is accordingly recommended that

- Deemed export should be brought at par with physical export for the purposes of refund of excise duty in order to address the issue of CENVAT accumulation with the industry.
- Alternatively, the accumulated CENVAT credit should be allowed to be adjusted against the purchase of inputs so that excise duty should not be paid again on such inputs resulting into further accumulation of CENVAT.

CENTRAL SALES TAX

5.6.1. Consider Inter-state Stock Transfer of Natural Gas on Deemed Movement Basis

As per Section 6A of the Central Sales Tax Act 1956, in case of inter-state stock transfer of goods, the burden of proving movement of goods is on the dealer. Section 6A of the Central Sales Tax Act 1956 provides that in case any dealer claims that he is not liable to pay tax under this Act on the ground that the movement of such goods from one state to another

was occasioned by reason of transfer of goods to any other place of his business (or to his agent or principal) and not sale, the burden of proving that the movement of those goods was so occasioned shall be on that dealer.

It may be observed that section 3 of CST Act, 1956 was amended by the Budget 2016 by inserting the following explanation-3 to allow deemed movement of Gas for inter-state sale:

"Where the gas sold or purchased and transported through a common carrier pipeline or any other common transport or distribution system becomes co-mingled and fungible with other gas in the pipeline or system and such gas is introduced into the pipeline or system in one State and is taken out from the pipeline in another State, such sale or purchase of gas shall be deemed to be a movement of goods from one State to another."

It is understood that aforesaid amendment was brought considering the very nature of the gas as a product which becomes co-mingled and fungible in the common pipeline transportation system. Natural Gas available from different sources is transported through inter connected cross country pipeline and it is inevitably and invariably comingled and/ or swapped for efficient and equitable distribution to various consumers in the different States.

As per section 6A of CST Act, a dealer has to establish actual physical movement of goods from one State to another in order to establish it as inter- state stock transfer of those goods. However, in case of Natural Gas, it is difficult to trace the molecules being transferred from one State to another as it commingles with other gas in the pipeline system. Further, in case of swapping, Gas is introduced in the pipeline distribution system in one State and taken out from the system in another State irrespective of actual physical movement and it is therefore not possible to claim a transaction as stock transfer transaction and may require multiple transactions of sale and purchase having tax implications in both States.

When the total quantity of Natural Gas is comingled, it will not be possible to segregate and treat sale & stock transfer differently. In fact, the Quantity for stock transfer has to be a balancing figure only after considering sale on deemed movement basis. Thus, it may be clear from the above that although it may not be possible to demonstrate physical movement for stock transfer, the treatment for stock transfer needs to be aligned with inter-state sale due to balancing requirement. Thus, the aforesaid amendment brought in the Section 3 of the Central Sales Tax Act 1956 by the Union Budget 2016 cannot be effective in meeting its objective till a similar amendment is brought in Section 6A of the CST Act.

With a view to develop cost effective and tax efficient mechanism for Gas swapping as well as to resolve the issues emerging from comingling of gas, it is requested that an amendment in Section 6A of the Central Sales Tax Act, 1956 may be introduced to effectively implement the amendment brought in Section 3 of the CST Act vide Union Budget 2016. A suggested draft of the proposed amendment is given below:

"The explanation 3 to section 3 will mutatis mutandis apply to inter-state transfer of Gas based on deemed movement."

5.6.2. Loss of Tax Cost In Cases of Sales Returns

As per Section 8A of the Central Sales Tax Act, 1956, the sale price of goods returned to the dealer by the purchaser of goods shall be deducted from the aggregate of the sale prices, provided inter-alia that the goods are returned within a period of six months from the date of delivery of goods. Additionally, as per the same Section 8A, deduction can be made from the turnover of dealer the value of sales returns within a period of six months only from date of delivery.

In India the apparel industry operates on a "two seasons" basis – winter and summer. The summer season is, in fact, a long season and closure of the season within six months is not feasible. As per industry practice, about 60% of the estimated demand for a season is placed in stores at the pre-season launch phase. At the end of the season, unsold garments (typically about 30% of the total goods placed) are returned to brand-owner by way of sales returns.

In most of the cases, sales returns are received after a period of six months from date of delivery, resulting in non-adjustment of CST paid on earlier sale. The problem is compounded by the fact that Assessing Authority issue Form C for the value of net purchases (which is net of returns) as disclosed in the VAT / CST return. Hence, Form C is not issued by the buyer for returns, which results in additional liability of differential tax for the dealer for returns received beyond six months.

It is recommended that in case of readymade garments period for acceptance of sales return may be extended to one year from date of delivery of goods, and, suitable clarifications be provided for issuance of Form – C on gross value of goods purchased. Alternately, the deduction for sales returns be allowed only for value of sales returns within a period of six months.

5.6.3. Conflict between the Special Economic Zone Act, 2005 and CST Act

Section 26 of the SEZ Act provides exemption from the levy of Central Sales Tax in respect of inter-state sale of goods which are meant to be used for the authorized operations of SEZ unit or developer. Further in terms of Section 51 of SEZ Act, provisions of the SEZ Act shall have over-riding effect notwithstanding anything inconsistent contained in any other law for the time being in force.

However, collective reading of Sub-section (6), Sub- section (7) and Sub-section (8) of Section 8 of the CST Act, 1956 restricts the exemption from levy of CST only to the last inter-state sale effected to the SEZ unit or developer whereas all prior inter-state sales are made subject to CST. In light of above, sales tax authorities in many states are denying exemption from the levy of CST to the value chain even when it is not in dispute that ultimate consumer for the goods sold in an SEZ unit or developer.

Suitable clarification may be issued under the CST Act, 1956 to specifically exempt the entire value chain right from the first dealer (who originated the movement of goods to the SEZ area) up to the dealer affecting the last sales to the SEZ Unit or developer.

5.6.4. Sale from SEZ Units to DTA Units to be treated Imports and Exempt from Levy of CST

While under the SEZ Act, sales from SEZ units to DTA units are treated as an import transaction for the purpose of levy of Customs duties, when it comes to the sales, such transactions are not treated as sale in the course of import. If such sales are treated as "Sale in the course of import under Section 5(2) of the Central Sales tax Act, 1956", they are exempt from levy of CST. In that event, Special additional duty (SAD) of 4% is leviable on such transactions. Presently when such goods are cleared into domestic tariff area, there is an exemption from SAD but CST is payable. CST is a cost to the buyers and no credit is available. However, SAD is cenvatable and hence the buyers who are manufacturers or dealers in excise, get the credit back.

The SEZ Act allows units in the zones to sell as much as they want to in DTA provided their overall foreign exchange earnings is more than the foreign exchange spent by them. However, payment of CST on domestic inter-state sales makes the products costly and thereby uncompetitive in the markets.

Hence, in order to encourage more domestic sales and also to ensure that the cost of the finished products is reduced, it is requested that such sales from SEZ units to DTA units should be treated as sale in the course of import and exempt from levy of CST.

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